PRUDENTIAL PLC
Form 20-F
April 16, 2013

As filed with the Securities and Exchange Commission on 16 April 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR (G) OF THE SECURITIES EXCHANGE ACT OF 1934
OR

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended 31 December 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 1-15040

PRUDENTIAL PUBLIC LIMITED COMPANY

(Exact Name of Registrant as Specified in its Charter)

England and Wales
(Jurisdiction of Incorporation)

12 Arthur Street,
London EC4R 9AQ, England
(Address of Principal Executive Offices)

David Martin
Head of Financial Accounting
Prudential plc
12 Arthur Street,
London EC4R 9AQ, England
+44 20 7548 3640
david.martin@prudential.co.uk
(Name, telephone, e-mail and/or facsimile number and address of company contact person)

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*
6.75% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Denominated Preference Shares	New York Stock Exchange
6.50% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Denominated Preference Shares	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 31 December 2012 was:

2,557,242,352 Ordinary Shares, 5 pence par value each

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes X No ___

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes ___ No X

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 whether the registrant has submitted electronically and posted on its corporate Web sites, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ___ No ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer X Accelerated filer ___ Non-accelerated filer ___

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ___ International Financial Reporting Standards as issued by the International Accounting Standards Board X Other ___

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 ___ Item 18 ___

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ____ No __X__

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

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As used in this document, unless the context otherwise requires, the terms 'Prudential', the 'Group', 'we', 'us' and 'our' each refer to Prudential plc, together with its subsidiaries, while the terms 'Prudential plc', the 'Company' or the 'parent company' each refer to 'Prudential plc'.

In the UK, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) replaced the Financial Services Authority (FSA) on 1 April 2013. The new regulatory environment in the UK is explained in Item 4 Supervision and Regulation. References made in this document to the FSA incorporate references to the PRA and FCA as appropriate.

Limitations on Enforcement of US Laws against Prudential, its Management and Others

Prudential is an English public limited company. Most of its directors and executive officers are resident outside the United States, and a substantial portion of its assets and the assets of such persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons or to enforce against them or Prudential in US courts judgments obtained in US courts predicated upon the civil liability provisions of the federal securities laws of the United States. We believe that there may be doubt as to the enforceability in England and Wales, in original actions or in actions for enforcement of judgments of US courts, of liabilities predicated solely upon the federal securities laws of the United States.

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Item 3. Key Information

SELECTED HISTORICAL FINANCIAL INFORMATION OF PRUDENTIAL

The following table sets forth selected consolidated financial data for Prudential for the periods indicated. Certain data is derived from Prudential's audited consolidated financial statements prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2012, there were no unendorsed standards effective for the years presented below affecting the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, the selected consolidated financial data presented below that is derived from Prudential's audited consolidated financial statements is derived from audited consolidated financial statements prepared in accordance with IFRS as issued by the IASB. 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'.

Income statement data

Year Ended 31 December	**2012**	**2012**	**2011**	**2010**	**2009**	**2008**
	$m(1)	**£m(1)**	**£m(3)**	**£m(3)**	**£m(3)**	**£m(3)**
Gross premium earned	**48,640**	**29,910**	25,706	24,568	20,299	18,993
Outward reinsurance premiums	**(823)**	**(506)**	(429)	(357)	(323)	(204)
Earned premiums, net of reinsurance	**47,817**	**29,404**	25,277	24,211	19,976	18,789
Investment return	**39,112**	**24,051**	9,360	21,769	26,889	(30,202)
Other income	**3,287**	**2,021**	1,869	1,666	1,234	1,146
Total revenue, net of reinsurance	**90,215**	**55,476**	36,506	47,646	48,099	(10,267)
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(74,729)**	**(45,953)**	(29,289)	(40,518)	(41,195)	10,824
Acquisition costs and other expenditure	**(9,847)**	**(6,055)**	(5,120)	(4,989)	(4,756)	(2,457)
Finance costs: interest on core structural borrowings of shareholder financed operations	**(455)**	**(280)**	(286)	(257)	(209)	(172)
Loss on sale of Taiwan agency business					(559)	
Total charges, net of reinsurance	**(85,031)**	**(52,288)**	(34,695)	(45,764)	(46,719)	8,195
Profit (loss) before tax (*being tax attributable to shareholders' and policyholders' returns*)(2)	**5,184**	**3,188**	1,811	1,882	1,380	(2,072)
Tax credit (charge) attributable to policyholders' returns	**(615)**	**(378)**	17	(611)	(818)	1,624
Profit (loss) before tax attributable to shareholders	**4,570**	**2,810**	1,828	1,271	562	(448)
Tax (charge) credit attributable to shareholders' returns	**(997)**	**(613)**	(409)	40	10	58
Profit (loss) from continuing operations after tax	**3,573**	**2,197**	1,419	1,311	572	(390)
Discontinued operations (net of tax)					(14)	

Profit (loss) for the year	**3,573**	**2,197**	1,419	1,311	558	(390)

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	2012	2012	2011	2010	2009	2008
	(In $m, Except Share Information)(1)	(In £m, Except Share Information)(1)				
Statement of financial position						
Total assets	**504,533**	**310,253**	272,745	260,040	227,103	214,858
Total policyholder liabilities and unallocated surplus of with-profits funds	**441,291**	**271,363**	236,290	224,980	196,417	182,391
Core structural borrowings of shareholder financed operations	**5,780**	**3,554**	3,611	3,676	3,394	2,958
Total liabilities	**487,679**	**299,889**	264,138	252,475	221,230	210,193
Total equity	**16,854**	**10,364**	8,607	7,565	5,873	4,665
Other data						
Based on profit (loss) for the year attributable to the equity holders of the Company:						
Basic earnings per share (in pence)	**140.7¢**	**86.5p**	55.8p	51.8p	22.3p	(16.0)p
Diluted earnings per share (in pence)	**140.5¢**	**86.4p**	55.7p	51.7p	22.2p	(16.0)p
Dividend per share declared and paid in reporting period (in pence)(6)	**41.70¢**	**25.64p**	25.19p	20.17p	19.20p	18.29p
Equivalent cents per share(7)		**40.68¢**	40.39¢	30.15¢	30.62¢	35.36¢
Market price per share at end of period(9)	**1407.5¢**	**865.5p**	638.5p	668.0p	640.0p	416.5p
Weighted average number of shares (in millions)		**2,541**	2,533	2,524	2,501	2,472
New business:						
Single premium sales(5)(8)	**36,359**	**22,358**	18,889	18,177	14,438	15,071
New regular premium sales(4)(5)(8)	**3,186**	**1,959**	1,792	1,667	1,401	1,330
Gross investment product contributions(5)	**157,678**	**96,961**	89,707	106,969	96,057	63,147
Funds under management(5)	**658,611**	**405,000**	351,000	340,000	290,000	249,000

(1)

Amounts stated in US dollars in the 2012 US dollar column have been translated from pounds sterling at the rate of $1.6262 per £1.00 (the noon buying rate in New York City on 31 December 2012).

(2)

This measure is the formal profit (loss) before tax measure under IFRS but is not the result attributable to shareholders. See 'Presentation of results before tax' in note A3 to Prudential's consolidated financial statements in Item 18 for further explanation.

(3)

The Group has adopted updated US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2008-2011 comparative results have been adjusted from those previously published for the retrospective application of the change as if the

new accounting policy had always applied, as described in note A5 to Prudential's consolidated financial statements in Item 18.

(4)

New regular premium sales are reported on an annualised basis, which represents a full year of instalments in respect of regular premiums irrespective of the actual payments made during the year.

(5)

The new business premiums in the table shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. The amounts shown are not, and are not intended to be, reflective of premium income recorded in the IFRS income statement. Internal vesting business is classified as new business where the contracts include an open market option.

The details shown above for new business include contributions for contracts that are classified under IFRS 4 'Insurance Contracts' as not containing significant insurance risk. These products are described as investment contracts or other financial instruments under IFRS. Contracts included in this category are primarily certain unit-linked and similar contracts written in UK insurance operations and Guaranteed Investment Contracts and similar funding agreements written in US operations.

Investment products included in the table for funds under management above are unit trust, mutual funds and similar types of retail fund management arrangements. These are unrelated to insurance products that are classified as 'investment contracts' under IFRS 4, as described in the preceding paragraph, although similar IFRS recognition and measurement principles apply to the acquisition costs and fees attaching to this type of business.

(6)

Under IFRS, dividends declared after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event. The appropriation reflected in the statement of changes in equity, therefore, includes the final dividend in respect of the prior year. Parent company dividends relating to the reporting period were an interim dividend of 8.40p per share in 2012 (2011: 7.95p, 2010: 6.61p) and a final dividend of 20.79p per share in 2012 (2011: 17.24p, 2010: 17.24p).

(7)

The dividends have been translated into US dollars at the noon buying rate on the date each payment was made.

(8)

The new business premiums shown, for the 2008-2010 comparative figures, exclude the new business premiums from the Group's Japanese insurance subsidiary, which ceased selling new business with effect from 15 February 2010. Japan's new business premiums for the year ended 31 December 2010 are shown in Item 4 'Asian Business'.

(9)

Market prices presented are the closing prices of the shares on the London Stock Exchange on the last day of trading for each indicated period.

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Dividend Data

Under UK company law, Prudential may pay dividends only if 'distributable profits' of the holding company are available for that purpose. 'Distributable profits' are accumulated, realised profits not previously distributed or capitalised less accumulated, realised losses not previously written off, on the applicable GAAP basis. 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. For further information about the holding company refer to Schedule II. The financial information in Schedule II has been prepared under UK GAAP reflecting the legal basis of preparation of the Company's separate financial statements as distinct from the IFRS basis that applies to the Company's consolidated financial statements.

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 With-profits Business' and Item 4, ' Information on the Company Supervision and Regulation of Prudential 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). Subject to the restrictions referred to 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 per share that Prudential declared for the periods indicated in pence sterling and converted into US dollars at the noon buying rate in effect on each payment date. Interim dividends for a specific year now generally have a record date in August and a payment date in September of that year, and final dividends now generally have a record date in the following March/April and a payment date in the following May.

Year	Interim Dividend	Interim Dividend	Final/Second Interim* Dividend	Final/Second Interim* Dividend
	(pence)	(US Dollars)	(pence)	(US Dollars)
2008	5.99	0.1112	12.91	0.2052
2009	6.29	0.1011	13.56	0.1976
2010	6.61	0.1039	17.24	0.2818
2011	7.95	0.1221	17.24	0.2706
2012	8.40	0.1362	20.79	

* The dividend of 13.56 pence for 2009 was paid as a second interim dividend. All other dividends shown in this column of the table are final dividends.

The Board has decided to rebase the full year dividend upwards by 4 pence, reflecting the strong progress made in both the earnings and free surplus[(1)] generation of the business and in the delivery of its financial objectives. In line with this, the directors recommend a final dividend of 20.79 pence per share (2011: 17.24 pence), which brings the total dividend for the year to 29.19 pence (2011: 25.19 pence), representing an increase of 15.9 per cent over 2011.

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(1)

Group free surplus at the end of the period comprises free surplus for the insurance businesses, representing the excess of the net worth over the required capital included in the EEV results, and IFRS net assets for the asset management businesses excluding goodwill. The free surplus generated during the period comprises the movement in this balance excluding foreign exchange, capital movements, and other reserve movements. Specifically, it includes amounts maturing from the in-force operations during the period less the investment in new business, the effect of market movements and other one-off items.

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

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 single currency adopted by the participating members of the European Union. The following table sets forth for each year the average of the noon buying rates on the last business day of each month of that 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.

Year ended 31 December	Average rate
2008	1.84
2009	1.62
2010	1.54
2011	1.61
2012	1.59

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
October 2012	1.62	1.59
November 2012	1.61	1.58
December 2012	1.63	1.60
January 2013	1.63	1.57
February 2013	1.58	1.51
March 2013	1.52	1.49

On 12 April 2013 the latest practicable date prior to this filing, the noon buying rate was £1.00 = $1.54.

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RISK FACTORS

A number of factors (risk factors) affect Prudential's operating results and financial condition and, accordingly, the trading price of its shares. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The information given is as of the date of this document, is not updated, and any forward-looking statements are made subject to the reservations specified below under 'Forward-Looking Statements'.

Risks relating to Prudential's business

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

Prudential's businesses are inherently subject to market fluctuations and general economic conditions. Uncertainty or negative trends in international economic and investment climates could adversely affect Prudential's business and profitability. Since 2008 Prudential has had to operate against a challenging background of periods of significant volatility in global capital and equity markets, interest rates and liquidity, and widespread economic uncertainty. Government interest rates have also fallen to historic lows in the US and UK and some Asian countries in which Prudential operates. These factors have, at times during this period, had a material adverse effect on Prudential's business and profitability.

In the future, the adverse effects of such factors would be felt principally through the following items:

- investment impairments or reduced investment returns, which could impair Prudential's ability to write significant volumes of new business and would have a negative impact on its assets under management and profit;

- higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses;

- Prudential in the normal course of business enters into a variety of transactions with counterparties, including derivative transactions. Failure of any of these counterparties to discharge their obligations, or where adequate collateral is not in place, could have an adverse impact on Prudential's results; and

- estimates of the value of financial instruments being difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain value and estimates of value require substantial elements of judgment, assumptions and estimates (which may change over time). Increased illiquidity also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline.

Global financial markets have experienced, and continue to experience, significant uncertainty brought on, in particular, by concerns over European and US sovereign debt, as well as concerns about a general slowing of global demand reflecting an increasing lack of confidence among consumers, companies and governments. Upheavals in the financial markets may affect general levels of economic activity, employment and customer behaviour. For example, insurers may experience an elevated incidence of claims, lapses, or surrenders of policies, and some policyholders may choose to defer or stop paying insurance premiums. The demand for insurance products may also be adversely affected. If sustained, this environment is likely to have a negative impact on the insurance sector over time and may consequently have a negative impact on Prudential's business and profitability. New challenges related to market fluctuations and general economic conditions may continue to emerge.

For some non-unit-linked investment products, in particular those written in some of the Group's Asian operations, it may not be possible to hold assets which will provide cash flows to match exactly

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those relating to policyholder liabilities. This is particularly true in those countries where bond markets are not developed and in certain markets where regulated surrender values are set with reference to the interest rate environment prevailing at the time of policy issue. This results in a mismatch due to the duration and uncertainty of the liability cash flows and the lack of sufficient assets of a suitable duration. While this residual asset/liability mismatch risk can be managed, it cannot be eliminated. Where interest rates in these markets remain lower than interest rates used to calculate surrender values over a sustained period, this could have an adverse impact on Prudential's reported profit.

In the US, fluctuations in prevailing interest rates can affect results from Jackson National Life Insurance Company (Jackson) which has a significant spread-based business, with the majority of its assets invested in fixed income securities. In particular, fixed annuities and stable value products written by Jackson expose Prudential to the risk that changes in interest rates, which are not fully reflected in the interest rates credited to customers, will reduce spread. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the policyholders' liabilities and the amounts that are credited to policyholders in the form of benefit increases, subject to minimum crediting rates.

Declines in spread from these products or other spread businesses that Jackson conducts could have a material impact on its businesses or results of operations. Jackson also writes a significant amount of variable annuities that offer capital or income protection guarantees. There could be market circumstances where the derivatives that it enters into to hedge its market risks may not fully offset its losses, and any cost of the guarantees that remain unhedged will also affect Prudential's results.

A significant part of the profit from Prudential's UK insurance operations is related to bonuses for policyholders declared on with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns. This profit could be lower in a sustained low interest rate environment.

Prudential is subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio

Prudential is subject to the risk of potential sovereign debt credit deterioration on the amounts of sovereign debt obligations, principally for UK, other European, US and Asian countries held in its investment portfolio. In recent years, rating agencies have downgraded the sovereign debt of some Continental European countries, the UK and the US. There is a risk of further downgrades for these countries. For some European countries the risk of default has also increased. Investing in such instruments creates exposure to the direct or indirect consequences of political, social or economic changes (including changes in governments, heads of states or monarchs) in the countries in which the issuers are located and the creditworthiness of the sovereign. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. In addition, the issuer of the debt or the governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or pay interest when due in accordance with the terms of such debt, and Prudential may have limited recourse to compel payment in the event of a default. A sovereign debtor's willingness or ability to repay principal and to pay interest in a timely manner may be affected by, among other factors, its cash flow situation, its relations with its central bank, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor's policy toward local and international lenders, and the political constraints to which the sovereign debtor may be subject. Periods of economic uncertainty may affect the volatility of market prices of sovereign debt to a greater extent than the volatility inherent in debt obligations of other types of issuers. If a sovereign were to default on its obligations, this could have a material adverse effect on Prudential's financial condition and results of operations.

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

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

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

Changes in government policy, legislation (including tax) or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates, which in some circumstances may be applied retrospectively, may adversely affect Prudential's product range, distribution channels, profitability, capital requirements and, consequently, reported results and financing requirements. Also, regulators in jurisdictions in which Prudential operates may change the level of capital required to be held by individual businesses or could introduce possible changes in the regulatory framework for pension arrangements and policies, the regulation of selling practices and solvency requirements. Furthermore, as a result of the recent interventions by governments in response to global economic conditions, it is widely expected that there will be a substantial increase in government regulation and supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transaction structure and enhanced supervisory powers.

Current EU directives, including the EU Insurance Groups Directive ('IGD') require European financial services groups to demonstrate net aggregate surplus capital in excess of solvency requirements at the group level in respect of shareholder-owned entities. The test is a continuous requirement, so that Prudential needs to maintain a higher amount of regulatory capital at the group level than otherwise necessary in respect of some of its individual businesses to accommodate, for example, short-term movements in global foreign exchange rates, interest rates, deterioration in credit quality and equity markets. The EU is also developing a regulatory framework for insurance companies, referred to as 'Solvency II'. The approach is based on the concept of three pillars Pillar 1 consists of the quantitative requirements, for example, the amount of capital an insurer should hold. Pillar 2 sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers. Pillar 3 focuses on disclosure and transparency requirements.

The Solvency II Directive covers valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements. A key aspect of Solvency II is that the assessment of risks and capital requirements are intended to be aligned more closely with economic capital methodologies, and may allow Prudential to make use of its internal economic capital models, if approved by the Financial Services Authority (FSA) or other relevant supervisory authority. The Solvency II Directive was formally approved by the Economic and Financial Affairs Council in November 2009. Representatives from the European Parliament, the European Commission and the Council of the European Union are currently discussing the Omnibus II Directive which, once approved, will amend certain aspects of the original Solvency II Directive. In addition, the European Commission is continuing to develop the detailed rules that will complement the high-level principles of the Directive, referred to

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as 'implementing measures'. The Omnibus II Directive is not currently scheduled to be finalised until late 2013, while the implementing measures cannot be finalised until after Omnibus II. There is a significant uncertainty regarding the final outcome of this process. In particular, the Solvency II rules relating to the determination of the liability discount rate and to the treatment of the US business remain unclear. As a result there is a risk that the effect of the measures finally adopted could be adverse for Prudential, including potentially a significant increase in capital required to support its business and that Prudential may be placed at a competitive disadvantage to other European and non-European financial services groups.

Currently there are also a number of other prospective global regulatory developments which could impact the way in which Prudential is supervised in its many jurisdictions. These include the Dodd-Frank Act in the US, the work of the Financial Stability Board (FSB) on Globally Systemically Important Financial Institutions (G-SIFIs) and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) being developed by the International Association of Insurance Supervisors (IAIS).

The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States that, among other reforms to financial services entities, products and markets, may subject financial institutions designated as systematically important to heightened prudential and other requirements intended to prevent or mitigate the impact of future disruptions in the US financial system, The full impact of the Dodd-Frank Act on Prudential's businesses is not currently clear, as many of its provisions have a delayed effectiveness and/or require rulemaking or other actions by various US regulators over the coming years.

As part of a global initiative to identify G-SIFIs, in May 2012, the IAIS published proposed assessment methodology for designating Globally Systemically Important Insurers (G-SIIs). For those groups that are designated by the FSB as G-SII, additional policy measures including enhanced supervision and higher loss absorbency requirements could be proposed. Further detail of the proposals is expected during 2013 and implementation is likely to be over a period of years. Furthermore, the FSA is considering the designation of a Domestically Systemically Important Insurer (D-SII) for those UK insurers that are significant in UK terms. It is not yet clear what the impact of this designation may be.

ComFrame is also being developed by the IAIS to provide common global requirements for the supervision of insurance groups. The framework is designed to develop common principles for supervision and so may increase the focus of regulators in some jurisdictions. It is also possible that some prescriptive requirements, including regarding group capital, could be proposed. Further clarity on ComFrame is expected during the second half of 2013.

Various jurisdictions in which Prudential operates have created investor compensation schemes that require mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant in the majority of its chosen markets, circumstances could arise where Prudential, along with other companies, may be required to make such contributions.

The Group's accounts are prepared in accordance with current International Financial Reporting Standards ('IFRS') applicable to the insurance industry. The International Accounting Standards Board ('IASB') introduced a framework that it described as Phase I, which permitted insurers to continue to use the statutory basis of accounting for insurance assets and liabilities that existed in their jurisdictions prior to January 2005. In July 2010, the IASB published an Exposure Draft for its Phase II on insurance accounting, which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts according to IFRS. The IASB continues its deliberation on the exposure draft principles but it remains uncertain whether the proposals in the Exposure Draft will become the final IASB standard. The timing of the changes taking effect is uncertain but not expected to be before 2017.

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

The resolution of several issues affecting the financial services industry could have a negative impact on Prudential's reported results or on its relations with current and potential customers

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally. These actions could involve a review of business sold in the past under acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pension and mortgage endowment policies, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices, including, in the latter case, businesses it has closed.

Regulators are increasingly interested in the approach that product providers use to select third party distributors and to monitor the appropriateness of sales made by them. In some cases, product providers can be held responsible for the deficiencies of third-party distributors.

In the US, federal and state regulators have focused on, and continue to devote substantial attention to, the mutual fund, fixed index annuity and insurance product industries. This focus includes new regulations in respect of the suitability of sales of certain products. As a result of publicity relating to widespread perceptions of industry abuses, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms.

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

Litigation, disputes and regulatory investigations may adversely affect Prudential's profitability and financial condition

Prudential is, and may be in the future, subject to legal actions, disputes and regulatory investigations in various contexts, including in the ordinary course of its insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of Prudential's businesses and operations that are specific to Prudential, or that are common to companies that operate in Prudential's markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by Prudential, and may be class actions. Although Prudential believes that it has adequately provided in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such provisions are sufficient. Given the large or indeterminate amounts of damages sometimes sought, other sanctions that might be applicable and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on Prudential's reputation, results of operations or cash flows.

Prudential's businesses are conducted in highly competitive environments with developing demographic trends and continued profitability depends on management's ability to respond to these pressures and trends

The markets for financial services in the UK, US and Asia are highly competitive, with several factors affecting Prudential's ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, developing demographic trends and customer appetite for certain savings products. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share,

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offer a broader range of products or have higher bonus rates or claims-paying ratios. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential's potential to grow its business as quickly as planned.

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

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

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

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

Downgrades in Prudential's financial strength and credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties

Prudential's financial strength and credit ratings, which are used by the market to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in most of Prudential's products, and as a result its competitiveness. Downgrades in Prudential's ratings, as a result of, for example, decreased profitability, increased costs, increased indebtedness or other concerns, could have an adverse effect on its ability to market products; retain current policyholders; and on the Group's financial flexibility. In addition, the interest rates Prudential pays on its borrowings are affected by its debt credit ratings, which are in place to measure the Group's ability to meet its contractual obligations.

Prudential's long-term senior debt is rated as A2 by Moody's, A+ by Standard & Poor's and A by Fitch. The Moody's and Fitch ratings are on stable outlook and the Standard & Poor's rating is on negative outlook.

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

The Prudential Assurance Company Limited's financial strength is rated Aa2 by Moody's, AA by Standard & Poor's and AA by Fitch. The Moody's and Fitch ratings are on stable outlook and the Standard & Poor's rating is on negative outlook.

Jackson's financial strength is rated AA by Standard & Poor's and Fitch, A1 by Moody's, and A+ by AM Best. The Moody's, Fitch and AM Best ratings are on stable outlook and the Standard & Poor's rating is on negative outlook.

In addition, changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or Prudential's financial condition.

Adverse experience in the operational risks inherent in Prudential's business could have a negative impact on its results of operations

Operational risks are present in all of Prudential's businesses, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. Prudential's business is dependent on processing a large number of complex

transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. Further, because of the long-term nature of much of the Group's business, accurate records have to be maintained for significant periods. These factors, among others, result in significant reliance on and require significant investment in information technology, compliance and other systems, personnel and processes. In addition, Prudential outsources several operations, including a significant part of its UK back office and customer-facing functions as well as a number of IT functions, resulting in reliance upon the operational processing performance of its outsourcing partners.

Although Prudential's systems and processes incorporate controls designed to manage and mitigate the operational risks associated with its activities, there can be no assurance that such controls will always be effective. For example, although the business has not experienced a material failure or breach in relation to IT systems and processes to date, failures or breaches of this sort, including a cyber-security attack, could harm its ability to perform necessary business functions and hurt its relationships with its business partners and customers. Similarly, any weakness in the administration systems or actuarial reserving processes could have an impact on its results of operations during the effective period. Prudential has not experienced or identified any operational risks in its systems or processes during 2012, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

Adverse experience relative to the assumptions used in pricing products and reporting business results could significantly affect Prudential's results of operations

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

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

Another example is the impact of epidemics and other effects that cause a large number of deaths. Significant influenza epidemics have occurred three times in the last century, but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Group's loss experience.

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

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As a holding company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments

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

As a holding company, Prudential's principal sources of funds are remittances from subsidiaries, shareholder-backed funds, the shareholder transfer from long-term funds and any amounts that may be raised through the issuance of equity, debt and commercial paper. Certain of the subsidiaries are restricted by applicable insurance, foreign exchange and tax laws, rules and regulations that can limit the payment of dividends, which in some circumstances could limit the ability to pay dividends to shareholders or to make available funds held in certain subsidiaries to cover operating expenses of other members of the Group.

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

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

Prudential's Articles of Association contain an exclusive jurisdiction provision

Under Prudential's Articles of Association, certain legal proceedings may only be brought in the courts of England and Wales. This applies to legal proceedings by a shareholder (in its capacity as such) against Prudential and/or its directors and/or its professional service providers. It also applies to legal proceedings between Prudential and its directors and/or Prudential and Prudential's professional service providers that arise in connection with legal proceedings between the shareholder and such professional service provider. This provision could make it difficult for US and other non-UK shareholders to enforce their shareholder rights.

Changes in tax legislation may result in adverse tax consequences

Tax rules, including those relating to the insurance industry, and their interpretation, may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its scope or interpretation could affect Prudential's financial condition and results of operations.

FORWARD-LOOKING STATEMENTS

This document may contain 'forward-looking statements' with respect to certain of Prudential's plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations and including, without limitation, statements containing the words "may", "will", "should", "continue", "aims", "estimates", "projects", "believes", "intends", "expects", "plans", "seeks" and

"anticipates", and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore undue reliance should not be placed on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, future market conditions, including fluctuations in interest rates and exchange rates and the potential for a sustained low-interest rate environment, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives related to the financial crisis and the effect of the European Union's 'Solvency II' requirements on Prudential's capital maintenance requirements; the impact of competition, economic growth, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal actions and disputes. These and other important factors may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. Further discussion of these and other important factors that could cause Prudential's actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential's forward-looking statements can be found under the 'Risk Factors' heading of this annual report, as well as under the 'Risk Factors' heading of any subsequent Prudential Half Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K.

Any forward-looking statements contained in this document speak only as of the date on which they are made. Prudential may also make or disclose written and/or oral forward-looking statements in reports filed with or furnished to the US Securities and Exchange Commission, the UK Financial Services Authority or other regulatory authorities, as well as in its annual report and accounts to shareholders, proxy statements, offering circulars, registration statements, prospectuses and, prospectus supplements, press releases and other written materials and in oral statements made by directors, officers or employees of Prudential to third parties, including financial analysts. All such forward-looking statements are qualified in their entirety by reference to the factors discussed under the 'Risk Factors' heading of this document, as well as under the 'Risk Factors' heading of any subsequent Prudential Half-Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K. These factors are not exhaustive as Prudential operates in a continually changing business environment with new risks emerging from time to time that it may be unable to predict or that it currently does not expect to have a material adverse effect on its business. Prudential expressly disclaims any obligation to update any of the forward-looking statements contained in this document or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, the Hong Kong Listing Rules, the SGX-ST listing rules or other applicable laws and regulations.

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EEV BASIS AND NEW BUSINESS RESULTS

In addition to IFRS basis results, Prudential's filings with the UK Listing Authority, the Stock Exchange of Hong Kong, the Singapore Stock Exchange and Group Annual Reports include reporting by Key Performance Indicators ('KPIs'). These include results prepared in accordance with the European Embedded Value ('EEV') Principles and Guidance issued by the Chief Financial Officers' ('CFO') Forum of European Insurance Companies, and New Business measures.

The EEV basis is a value based method of reporting in that it reflects the change in the value of in-force long-term business over the accounting period. This value is called the shareholders' funds on the EEV basis which, at a given point in time, is the value of future cash flows expected to arise from the current book of long-term insurance business plus the net worth (based on statutory solvency capital or economic capital where higher and free surplus) of Prudential's life insurance operations. Prudential publishes its EEV results semi-annually in the UK, Hong Kong and Singapore markets.

New Business results are published quarterly and are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. New business results are categorised as single premiums and annual regular premiums. New business results are also summarised by annual premium equivalents (APE) which are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. The amounts are not, and are not intended to be, reflective of premium income recorded in the IFRS income statement. EEV basis new business profits and margins are also published quarterly.

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Item 4. Information on the Company

BUSINESS OF PRUDENTIAL

Overview and Summary of Strategy

Overview

Prudential is an international financial services group, with significant operations in Asia, the United States and the United Kingdom. It has been in existence for over 160 years, serves around 24 million insurance customers globally and has £405 billion in assets under management (as at 31 December 2012). Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

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

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

As at 31 December 2012, Prudential Corporation Asia had:

- 13 million insurance customers with life and fund management operations in 12 markets;
- distribution relationships with over 77 institutions across Asia including Standard Chartered Bank (SCB), United Overseas Bank Limited (UOB) and joint venture partners ICICI in India and CITIC in China;
- one of the largest networks of tied agents in Asia; and
- consistently high brand recognition, outperforming many other financial services companies and had received multiple awards for its customer service. Prudential was in the top three for market share of new business in India, Indonesia, Malaysia, Singapore, the Philippines and Vietnam.

In the United States, Prudential offers a range of products through Jackson, including fixed annuities (fixed interest annuities, fixed index and immediate annuities), variable annuities and institutional products (including guaranteed investment contracts and funding agreements). Although Jackson historically also offered traditional life insurance products, it discontinued new sales of life insurance products effective 1 August 2012. Jackson distributes these products through independent insurance agents; independent broker-dealers; regional broker-dealers; wirehouses; registered investment advisers; and banks, credit unions and other financial institutions.

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

As at 31 December 2012, in the United States, Jackson:

- was among the 20 largest life insurance companies in terms of general account assets[(2)];
- was a top two player in US variable annuities[(3)];
- was once again awarded the 'Highest Customer Satisfaction by Industry' award for the seventh successive year from Service Quality Measurement Group; and
- was once again rated as a 'World Class' service provider for the seventh successive year by Service Quality Measurement Group.

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

As at 31 December 2012, Prudential UK:

- was one of the market leaders in the individual annuity market and the with-profits market[(4)]; and
- had total company assets of £158 billion on the balance sheet, comprising £93 billion within the with-profits sub fund, £57 billion within shareholder-backed business and £8 billion in the Scottish Amicable Insurance Fund.

As at 31 December 2012, M&G:

- had responsibility for £228 billion of investment on behalf of both internal and external clients; and
- M&G's retail business has been awarded the prestigious Outstanding Investment House of the Year 2012 Award for the third year running at the OBSR Awards. M&G's institutional business was recognised for its strength and expertise at the UK Pensions Awards, where it was named Fixed Income Manager of the Year 2012.

Group Strategy Overview

Prudential's strategy has remained consistent: to accelerate growth in Asia; to build on the strength of US operations; to focus the UK business and optimise asset management.

In a turbulent environment, the Group has continued to take proactive and decisive management action to deliver on strategy. In this industry, distribution is absolutely key. Therefore the Group has continued to strengthen its ability to reach its chosen customers in its chosen markets. For instance, Prudential has strengthened its distribution in Thailand by establishing an exclusive partnership with

(2) Source: Third Quarter 2012 SNL Financial

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

(4) Source: Association of British Insurers (ABI)

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Thanachart Bank, a leading bank in this market, and through the acquisition of its life business, Thanachart Life. In the US, the Group has continued to invest in distribution as well, strengthening relationships with partners. Throughout the year, Prudential has ensured that it puts value ahead of volume, ensuring that it reached its return on capital and payback targets. To mention a few examples, in Malaysia the Group refocused the business on higher-value, lower-volume protection business. In Korea and in Taiwan, at times during the year, Prudential refused to write poor value business, sacrificing some sales and growth in the process.

Prudential has maintained its bias in favour of insurance income and fee income, which have grown as a proportion of profits, ahead of spread income. True to that logic, in the US Prudential acquired Reassure America Life Insurance Company (REALIC), which increased its insurance income. The Group also continues to drive its product mix to achieve the optimal balance between growth in sales, profit growth, cash generation and capital strength. Therefore, it has continued to emphasise and to grow protection products in Asia, which also provide excellent value to customers. In the US, the Group has seen growing demand for Elite Access, a variable annuity without guarantees, launched in March 2012. Elite Access allows the Group to meet the needs of a key customer segment and to grow profitably while staying within our quantitative risk appetite in the year. Prudential believes Elite Access has excellent prospects in the US market. More generally, The Group has continually and proactively re-priced products and modified their features to ensure they continued to generate adequate returns in the new interest rate environment.

The Group's strategy is supported by three key Group-wide operating principles.

First, it takes a balanced approach to performance management across the key measures of IFRS, EEV and cash, with a particular focus on IFRS and cash. Second, it focuses on allocating capital to the highest return and shortest payback opportunities across the Group taking strong action where necessary, such as deliberately reducing sales in geographies, products or channels where its return and payback criteria are not met. Third, the Group is proactive in managing risk across the cycle.

The Group continues to focus on promoting transparency by providing shareholders with relevant disclosures about its business and how they run it, to ensure that both its strategy and its operating principles are well understood. In addition to the disclosures that are provided with its quarterly financial results, since 2010 it has organised an annual seminar to provide investors and analysts with a further opportunity to discuss the business in detail with the Group's senior management.

The Group has organised three investor seminars in London (on 1 December 2010), Kuala Lumpur (on 15 November 2011), and New York (on 29 November 2012). These seminars consisted of presentations on different aspects of its business including: Group strategy; its operating principles; the 2013 'Growth and Cash' objectives; its Asian business, including country-by-country presentations; and Jackson, with further insights into its hedging strategy, capital position and sensitivity to market shocks. The Group intends to hold a fourth annual seminar in the last quarter of 2013 in London.

Company Address and Agent

Prudential plc is a public limited company incorporated on 1 November 1978, and organised under the laws of England and Wales. Refer to Item 10, 'Additional information Memorandum and Articles of Association' for further information on the constitution of the Company.

Prudential's registered office is Laurence Pountney Hill, London EC4R 0HH, England (telephone: +44 20 7220 7588) and its principal executive offices are at 12 Arthur Street, London EC4R 9AQ, England (telephone: +44 20 7220 7588). Prudential's agent in the United States for purposes of Item 4 of this annual report on Form 20-F is Jackson National Life Insurance Company, located at 1 Corporate Way, Lansing, Michigan 48951, United States of America.

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Significant Subsidiaries

The table below sets forth Prudential's significant subsidiaries.

Name of Company	Main activity	Percentage Owned(1)	Country of incorporation
The Prudential Assurance Company Limited	Insurance	100%	England and Wales
Prudential Annuities Limited[2]	Insurance	100%	England and Wales
Prudential Retirement Income Limited (PRIL)[2]	Insurance	100%	Scotland
M&G Investment Management Limited[2]	Asset management	100%	England and Wales
Jackson National Life Insurance Company[2]	Insurance	100%	US
Prudential Assurance Company Singapore (Pte) Limited[2]	Insurance	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, except for Prudential Retirement Income Limited which operates mainly in England and Wales.

(2) Owned by a subsidiary of Prudential.

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Asian Business

Life Insurance

Introduction

Asia's rapidly growing middle classes remain a key growth driver for the retail financial services sector, particularly life insurance with an emphasis on protection. Research has shown that as the middle class becomes more established the proportion of income they allocate to financial planning increases from 5 per cent to around 12 per cent[5]. The manifestation of this demand varies significantly across the region, reflecting the various stages of development in each individual market, together with their distinct regulatory and competitive environments, cultural differences and customer preferences. However, across all markets there is increasing recognition among governments and regulators of the social utility of a vibrant private sector life insurance market that provides financial security to families, efficiently channels long-term savings into financial markets and generates employment opportunities within the industry.

Our strategy in Asia is focused on meeting the needs of the emerging middle class in the region for savings and protection. The region's positive demographics, strong economic growth, sound public finances and favourable public policy environment with a clear preference for private provision of protection, have all led to a rapidly expanding middle class, with a strong and growing demand for our savings and protection products.

On 2 July 2012 we announced that Prudential has received in-principle approval from Cambodia's Ministry of Economy and Finance to establish a wholly foreign-owned life insurance operation in the country. Although the Cambodian economy is relatively small at present, it has delivered strong GDP growth over the past ten years and we see excellent opportunities to develop the life insurance industry in the coming years. The business sold its first policies in January 2013.

On 5 November 2012, Prudential plc , through its subsidiary Prudential Life Assurance (Thailand) Public Company Limited ('Prudential Thailand') entered into an agreement to acquire 100 per cent of Thanachart Life Assurance Company Limited ('Thanachart Life'), a wholly-owned life insurance subsidiary of Thanachart Bank Public Company limited ('Thanachart Bank'). The transaction was approved by the regulator in March 2013 and is expected to close in the second quarter of 2013. As part of the deal, Prudential Thailand and Thanachart Bank have entered into an agreement to establish an exclusive 15-year partnership to develop jointly their bancassurance business in Thailand. This transaction builds on Prudential's strategy of focusing on the highly attractive markets of South-East Asia and is in line with the group's multichannel distribution strategy.

Overall, our geographic footprint, combined with the exceptional quality of our distribution and of our products, has enabled us to deliver another year of very strong performance in Asia. Our 13 million insurance customers, whom we serve well and profitably, represent only a small proportion of the long-term potential of this part of the world for our company.

Distribution

Prudential's strategy in Asia is well established and continues to be highly effective. The customer is at the heart of our strategy and Asian customers find our offering of regular premium savings and protection products distributed principally through high quality face to face distribution channels particularly attractive. The quality of our brand, our products, and of our distribution allows us to translate our sales in to strong returns to our shareholders.

Building and strengthening Prudential's multichannel distribution capabilities is a constant objective for us. Tied-agency remains a highly effective and efficient distribution channel in Asia and Prudential

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(5) HSBC Global Research

has one of the region's largest agency forces. We focus both on the size and the productivity of our agency force.

Prudential has a diverse range of successful bank distribution partnerships across the region that includes regional relationships with international banks such as Standard Chartered and local ones such as E.Sun in Taiwan. Prudential is also successful in working with multiple partners in one market. Key drivers of this success are a long-term commitment to creating value for both partners, expertise in developing, training and motivating bank sales teams and committed marketing support. Bancassurance has been growing rapidly in the region in recent years and Prudential remains a regional leader in this channel, led by highly productive relationships including SCB and UOB. As described above, in November 2012, Prudential announced a new and strategically significant, exclusive long-term partnership with Thailand's Thanachart Bank as part of a deal that will see Thanachart Life merged with our existing life operation in the country immediately doubling our market share. The deal is expected to complete during the first half of 2013.

Products

The life insurance products offered by Prudential in Asia include with-profits (participating) and non-participating term, whole life and endowment and unit-linked policies often combined with protection riders and typically with regular premium payments. Prudential in Asia also offers health, disablement, critical illness and accident cover to supplement its core life products. Prudential's product mix is orientated around a core of regular premium policies with protection riders. The portfolio is regularly refreshed with new features and benefits that keep pace with evolving customer needs and also drive sales force activities.

It is part of our strategy to focus on regular premium products which allow our customers to invest over the long term. We aim to make most of our sales as regular premiums and the proportion of regular premium business has been consistently high, which ensures the profitability and resilience of our growing in-force book. Although single premium products can provide appropriate opportunities for customers with lump sums, we believe that regular premium policies with protection riders best meet the majority of our customers' needs.

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

Policyholder and insurer share the profits from participating policies (typically in a 90:10 ratio) in the same way as with-profits business in the UK. With unit-linked products, shareholders receive the profits arising from managing the policy, its investments and the insurance risk. Policyholders within the underlying unitised fund receive investment gains. The profits from accident and health and non-participating products come from any surplus remaining after paying policy benefits.

At the end of 2012, Prudential is offering unit-linked products in all markets except Thailand and Vietnam. However, given the recent volatility in the financial markets, we have seen a shift towards non linked products.

Critical factors in Prudential's success in health and protection include integrating the product initiatives with the distribution channels and tailoring sales support activities to the sales force. For example, health products have been incorporated into agency incentive programs and a standalone

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healthcare product was launched into the SCB channel with simplified underwriting and compelling media campaigns to capture direct business and provide leads for other channels.

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

In addition to providing value directly to our customers through our products and services, we aim to provide wider benefits to the community where we operate. Therefore, Prudential supports a range of corporate social responsibility activities across Asia, with a focus on providing disaster relief, promoting financial literacy and benefiting children. During 2012, Prudential extended its highly successful children's financial literacy programme, 'Cha-Ching', for example this has now been adopted in the Philippines as part of the school curriculum.

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New Business Premiums

In 2012, total sales of insurance products, excluding Japan, were £3,308 million, up 11 per cent from 2011 (£2,970 million). Of this amount, regular premium insurance sales increased 15 per cent to £1,740 million and single premium insurance sales increased 8 per cent to £1,568 million.

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

	2012	2011	2010
	£m	£m	£m
Single premiums			
Singapore	**399**	371	318
Hong Kong	**157**	180	107
Malaysia	**98**	79	58
Taiwan (excluding Taiwan agency)	**172**	217	146
Korea	**94**	71	66
China (Prudential's 50% interest in joint venture with CITIC)	**37**	46	103
Indonesia	**359**	250	141
India (Prudential's 26% interest in joint venture with ICICI)	**67**	135	85
Other countries	**185**	107	80
Total excluding Japan	**1,568**	1,456	1,104
Japan			13
Total including Japan	**1,568**	1,456	1,117
Regular premiums			
Singapore	**261**	198	143
Hong Kong	**380**	313	276
Malaysia	**208**	215	198
Taiwan (excluding Taiwan agency)	**138**	126	105
Korea	**86**	94	89
China (Prudential's 50% interest in joint venture with CITIC)	**53**	54	48
Indonesia	**410**	338	269
India (Prudential's 26% interest in joint venture with ICICI)	**96**	88	180
Other countries	**108**	88	83
Total excluding Japan	**1,740**	1,514	1,391
Japan			6
Total including Japan	**1,740**	1,514	1,397
Total			
Total excluding Japan	**3,308**	2,970	2,495
Japan*			19
Total including Japan	**3,308**	2,970	2,514

* The Group's Japanese insurance subsidiary ceased selling new business with effect from 15 February 2010.

Eastspring Investments

Prudential's asset management business in Asia manages investments for Asia's third-party retail and institutional clients in addition to investments of Prudential's Asia, UK and US life companies. It has operations in 11 markets, including Indonesia which was successfully opened during 2012, increasing our asset management footprint in the region.

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

Eastspring Investment's leading presence in Asia was acknowledged, when it was ranked the largest retail asset manager in Asia (based on assets sourced from Asia ex-Japan) as at 30 June 2012, in a survey conducted by Asia Asset Management magazine. Eastspring Investments also received multiple accolades for its investment capabilities, including four fund managers from Singapore, Malaysia and Indonesia being named '2012 Most Astute Investors in Asian currency bonds' by The Asset Benchmark Research and the joint venture business in India being recognised as the 'Best Debt Fund House of the year' in Morningstar Awards 2012.

Distribution

In order to capitalise on the sizeable opportunities in Asia's retail financial services market, Eastspring Investments maintained its focus on building a strong third-party customer retail franchise. The customer proposition is driven by Eastspring Investments' investment capabilities, which enable it to develop innovative product suites, and distribute them through diverse channels including regional banks, local banks, private banks, and securities houses and an internal sales force.

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

Products

Eastspring Investments offers mutual fund investment products in India, Taiwan, Japan, Singapore, Malaysia, Hong Kong, Korea, Vietnam, China and now Indonesia, thus enabling customers to participate in debt, equity and money market investments across the region.

Markets in Asia remained challenging in 2012. Equity funds struggled to gain traction due to poor investor sentiment in the face of weak macroeconomic signals. Fixed income and regular yield products remained in favour.

Net flows and funds under management

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

Total funds under management (FUM) reached a record £58.1 billion at the end of 2012 (2011: £50.3 billion: 2010: £51.9 billion) representing a 16 per cent increase from a year ago on the back of strong net inflows and positive market movements, while net third party inflows (excluding MMF) of £1,626 million were driven by net inflows in India, Taiwan and China.

Specifically, strong fund raising was seen in India for our fixed maturity plan range and open-ended bond funds, while the Taiwan business saw a successful launch of the Emerging Asian Local Fixed Income Fund in the first half of the year and the Global Aggregate Strategy High Yield Bond Fund in the second half. In addition, Taiwan's existing range of onshore and offshore bond funds also generated significant net inflows in 2012. In China, both the CSI 500 Index Fund and the Tianjin Split Bond Fund

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launched in second half of the year attracted positive flows. The positive net flows were partially offset by redemptions from an institutional client in Singapore and another in Korea.

US Business

Prudential conducts its US insurance operations through Jackson National Life Insurance (Jackson) and its subsidiaries, including Curian Capital, a registered investment adviser. The US operations also include PPM America, Prudential's US internal and institutional fund manager, and Prudential's US broker dealer operations (National Planning Corporation, SII Investments, INVEST Financial Corporation and Investment Centers of America). As at 31 December 2012, Prudential's US operations had more than 4.7 million policies and contracts in effect (including those acquired through the purchase of REALIC as described below) and PPM America managed approximately £63.9 billion of assets. In 2012, new business premiums totalled £14,516 million.

Jackson

Jackson is a leading provider of retirement income and savings solutions in the mass and mass-affluent segments of the US market, primarily to those planning for retirement or in retirement already. It offers tools that help people plan for their retirement, and offers products with specialised features and guarantees to meet customers' needs. By seeking to add value to both the representatives who sell Jackson products, and to their customers, Jackson has built a strong position in the US retirement savings and income market with an almost ten-fold increase in variable annuity sales over the past decade. Over the same period, Jackson increased its total annuity market share from 2.3 per cent in 2001 to 10.4 per cent in 2012 and moved from 17th in total annuity sales to 1st[6].

Jackson's strategy remains focused on providing value to its customers and driving shareholder value while operating within a conservative risk management framework. This approach has enabled us to successfully navigate the significant macroeconomic and financial market challenges of the last five years and ensured a continuation of our strong performance in 2012.

In 2012, Jackson delivered a higher retail sales than 2011 and had a modest benefit from institutional sales. Retail annuity net flows continued to benefit from increased sales and low levels of surrender activity.

We believe that Jackson continues to be one of the most efficient operators within the US life insurance market. The ratio of statutory general expenses to average assets improved slightly to 41 basis points in 2012 versus 42 basis points in 2011. This efficiency has been delivered while maintaining world class standards of customer service for our contract holders. In 2012, Jackson was rated as a 'World Class' service provider by the Service Quality Measurement Group for the seventh consecutive year.

On 4 September 2012, Jackson completed the acquisition of SRLC America Holding Corp (SRLC) from Swiss Re for a consideration of £370 million which is subject to finalisation of completion procedures. SRLC was the US holding company of REALIC. The acquisition helps diversify Jackson's sources of earnings by increasing the amount of income generated from underwriting activities. The transaction is expected to add an additional £100 million to Jackson's IFRS pre-tax profits in the first year, representing stand-alone earnings from REALIC of approximately £115 million, less £15 million of income foregone on the assets sold to finance the transaction. In the four month period since completion, REALIC contributed £67 million to Jackson's IFRS operating profit based on longer-term investment returns while having only a modest impact on statutory capital. SRLC's primary subsidiary was REALIC, which was merged into Jackson on 31 December 2012. REALIC's primary business activity involved the acquisition of blocks of life insurance. In addition to REALIC, SRLC had other insignificant subsidiaries. Subsequent to the purchase SRLC was dissolved and its subsidiaries became direct subsidiaries of Jackson.

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(6) Source: Third Quarter 2012 Life Insurance and Market Research Association.

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

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

Products

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

	Year Ended 31 December		
	2012	**2011**	**2010**
	£m	**£m**	**£m**
By Product			
Annuities			
Fixed annuities			
Interest sensitive	**550**	441	755
Fixed index	**1,094**	934	1,089
Immediate	**31**	31	81
Variable annuities	**12,445**	10,909	9,481
Total	**14,120**	12,315	11,406
Life insurance	**17**	29	33
Institutional products			
GICs, funding agreements and Federal Home Loan Bank of Indianapolis (FHLBI) advances	**379**	237	
Total	**14,516**	12,581	11,439
By Distribution Channel			
Independent broker dealer	**8,319**	7,471	6,503
Bank	**2,705**	2,135	2,285
Regional broker dealer	**2,421**	2,075	1,789
Independent agents	**682**	643	846
Institutional products department	**379**	237	
Captive agents	**10**	20	16
Total	**14,516**	12,581	11,439

Of the total new business premiums of £14,516 million in 2012 (2011: £12,581 million; 2010: £11,439 million), £14,125 million (2011: £12,325 million; 2010: £11,417 million) were single premiums, £12 million (2011: £19 million; 2010: £22 million) were regular premiums and £379 million (2011: £237; 2010: nil) were institutional product premiums.

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Annuities

Fixed Annuities

Interest-sensitive Annuities

In 2012, interest-sensitive fixed annuities accounted for 4 per cent (2011: 4 per cent) of total new business premiums and 13 per cent (2011: 16 per cent) of policy and contract liabilities of the US operations. Interest-sensitive fixed annuities are primarily deferred annuity products that are used for asset accumulation in retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The contract holder of an interest-sensitive fixed annuity pays Jackson a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and in some cases administrative charges are deducted from the contract holder's account. Jackson makes benefit payments at a future date as specified in the policy based on the value of the contract holder's account at that date. On more than 83 per cent (2011: 90 per cent) of in-force business, Jackson may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, Jackson either pays the contract holder the amount in the contract holder account or begins making payments to the contract holder in the form of an immediate annuity product. This latter product is similar to a UK annuity in payment.

At 31 December 2012, Jackson had fixed interest rate annuities totalling £11.7 billion (US$19.0 billion) (2011: £11.5 billion (US$17.8 billion) in account value with minimum guaranteed rates ranging from 1.0 per cent to 5.5 per cent and a 3.09 per cent average guaranteed rate (2011: 1.0 per cent to 5.5 per cent and a 3.08 per cent average guaranteed rate).

Fixed interest rate annuities are subject to early surrender charges for the first six to nine years of the contract. In addition, the contract may be subject to a market value adjustment at the time of surrender. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Jackson's profits on fixed annuities arise primarily from the spread between the return it earns on investments and the interest credited to the contract holder's account, less expenses. The fixed annuity portfolio could be impacted by the continued low interest rate environment as lower crediting rates could result in increased surrenders and lower sales if customers seek alternative investment opportunities.

Approximately 50 per cent (2011: 48 per cent) of the interest sensitive fixed annuities Jackson wrote in 2012 provide for a market value adjustment that could be positive or negative, on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment.

Fixed Indexed Annuities

Fixed indexed annuities (FIA) accounted for 7 per cent (2011: 7 per cent) of total new business premiums in 2012 and 8 per cent (2011: 9 per cent) of Jackson's policy and contract liabilities. Fixed indexed annuities vary in structure, but generally are deferred annuities that enable the contract holder to obtain a portion of an equity-linked return (based on participation rates and caps) but provide a guaranteed minimum return. These guaranteed minimum rates are generally set at 1.0 to 3.0 per cent on indexed funds. Jackson had fixed indexed annuities allocated to indexed funds totalling £5.6 billion (US$9.2 billion) (2011: £5.0 billion (US$7.8 billion)) in account value with minimum guaranteed rates on indexed accounts ranging from 1.0 per cent to 3.0 per cent and a 1.82 per cent average guaranteed rate (2011: 1.0 per cent to 3.0 per cent and a 1.76 per cent average guarantee rate). Jackson also offers fixed interest accounts on some fixed indexed annuity products. Fixed interest accounts on fixed indexed annuities totalled £1.5 billion (US$2.3 billion) (2011: £1.4 billion (US$2.1 billion)) in account

value with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 2.53 per cent average guaranteed rate (2011: 1.0 per cent to 3.0 per cent and a 2.50 per cent average guarantee rate).

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

Jackson hedges the equity risk return on fixed indexed products using futures and options linked to the relevant index as well as through offsetting equity exposure in the VA product. The cost of the hedges is taken into account in setting the index participation rates or caps. Jackson bears the investment and surrender risk on these products.

Immediate Annuities

In 2012, immediate annuities accounted for less than one per cent (2011: less than one per cent) of total new business premiums and one per cent (2011: one per cent) of Jackson's policy and contract liabilities. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years and/or the life of the contract holder. If the term is for the life of the contract holder, then Jackson's primary risk is mortality risk. This product is generally used to provide a guaranteed amount of income for contract holders and is used both in planning for retirement and in retirement itself. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

Variable Annuities

In 2012, variable annuities accounted for 86 per cent (2011: 87 per cent) of total new business premiums and 60 per cent (2011: 63 per cent) of Jackson's policy and contract liabilities. Variable annuities are deferred annuities that have the same tax advantages and payout options as interest-sensitive and fixed indexed annuities. They are also used for asset accumulation in retirement planning and to provide income in retirement.

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

At 31 December 2012, Jackson had fixed interest rate accounts within variable annuities totalling £4.3 billion (US$7.0 billion) (2011: £4.3 billion (US$6.7 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 1.89 per cent average guaranteed rate (2011: 1.0 per cent to 3.0 per cent and a 1.99 per cent average guaranteed rate).

Jackson offers a choice of guaranteed benefit options within its variable annuity product portfolio, which customers can elect and pay for. These include the guaranteed minimum death benefits ('GMDB'), which guarantee that, upon death of the owner, the beneficiary receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the return of original premium, the highest past anniversary value of the contract, or as the original premium accumulated at a fixed rate of interest. In addition, there are three other types of guarantees: guaranteed minimum

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withdrawal benefits ('GMWB'), guaranteed minimum accumulation benefits ('GMAB') and guaranteed minimum income benefits ('GMIB'). GMWBs provide a guaranteed return of the principal invested by allowing for periodic withdrawals that are limited to a maximum percentage of the initial premium. One version of the GMWBs provides for a minimum annual withdrawal amount that is guaranteed for the contract holder's life without annuitisation. GMABs generally provide a guarantee for a return of a certain amount of principal after a specified period. This benefit was eliminated from Jackson's product offerings in 2011. GMIBs provide for a minimum level of benefits upon annuitisation regardless of the value of the investments underlying the contract at the time of annuitisation. Jackson no longer offers GMIBs, with existing coverage being reinsured with an unaffiliated reinsurer.

As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of hedging and eventual payment of benefits guarantees. In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business to effectively manage Jackson's equity exposure. Jackson believes that the internal management of equity risk coupled with the utilisation of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure.

Profits in the variable annuity book of business will continue to be subject to the impact of market movements on both sales and allocations to the variable accounts and the effects of the economic hedging programme. Hedging is conducted based on an economic approach so, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility.

In March 2012, Jackson launched a new variable annuity product, Elite Access, which has no guaranteed benefits and provides tax efficient access to alternative investments. This product has received a positive reaction from distributors and Jackson is optimistic about the future of the Elite Access product and will continue to drive product innovation as a way of both meeting the needs of its customers and driving shareholder value.

Aggregate distribution of account values

The table below shows the distribution of account values for fixed annuities (interest-sensitive and fixed indexed) and variable annuities within the range of minimum guaranteed interest rates as described above as at 31 December 2012 and 2011:

	Account value	
	2012	**2011**
	£m	**£m**
Minimum guaranteed interest rate annuities		
1.0%	**2,534**	1,988
> 1.0% 2.0%	**8,374**	8,321
> 2.0% 3.0%	**9,174**	9,352
> 3.0% 4.0%	**1,236**	841
> 4.0% 5.0%	**1,518**	1,425
> 5.0% 5.5%	**209**	167
Total	**23,045**	22,094

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Life Insurance

Background

Reflecting the competitive life insurance market and the overall trend towards asset accumulation products, Jackson's life insurance products accounted for less than 1 per cent (2011: less than 1 per cent) of the total new business premiums and 15 per cent (2011: 7 per cent) of Jackson's policy and contract liabilities in 2012. The increase in policy and contract liabilities and the distribution of account values within a range of minimum guaranteed interest rates as shown below was a result of the acquisition of REALIC. Jackson discontinued new sales of life insurance products effective 1 August 2012. Previously, Jackson sold several types of life insurance, including term life, universal life and variable universal life. Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a type of life insurance policy that combines death benefit protection with the ability for the contract holder account to be invested in separate account funds. Jackson's life insurance book has delivered consistent profitability, driven primarily by positive mortality and persistency experience.

Aggregate distribution of account values

At 31 December 2012, Jackson had interest sensitive life business in force with a total account value of £6.0 billion (US$9.7 billion) (2011: £3.3 billion (US$5.1 billion)), with minimum guaranteed interest rates ranging from 2.5 per cent to 6.0 per cent with a 4.67 per cent average guaranteed rate (2011: 3.0 per cent to 6.0 per cent with a 4.88 per cent average guaranteed rate). The table below shows the distribution of the interest-sensitive life business account values within this range of minimum guaranteed interest rates as at 31 December 2012 and 2011:

	Account value	
	2012	**2011**
	£m	**£m**
Minimum guaranteed interest rate interest sensitive life business		
> 2.0% 3.0%	**183**	130
> 3.0% 4.0%	**2,141**	1,145
> 4.0% 5.0%	**2,097**	686
> 5.0%	**1,550**	1,317
Total	**5,971**	3,278

Institutional Products

Institutional products consist of traditional guaranteed investment contracts ('GICs'), funding agreements (including agreements issued in conjunction with Jackson's participation in the US Federal Home Loan Bank of Indianapolis ('FHLBI') programme) and medium-term note funding agreements. In 2012, institutional products accounted for three per cent (2011: two per cent) of total new business premiums and three per cent (2011: 4 per cent) of Jackson's policy and contract liabilities. Jackson sold no institutional products during 2010, as available capital was directed to support higher margin variable annuity sales. In 2012 and 2011, Jackson re-entered the institutional market on a limited and selective basis, taking advantage of high returns available at particular times during the year. The GICs are marketed by the institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its programme.

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Traditional Guaranteed Investment Contracts

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

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

Jackson sells GICs to retirement plans, in particular 401(k) plans. The traditional GIC market is extremely competitive. This is due in part to competition from synthetic GICs, which Jackson does not sell.

Funding Agreements

Under a funding agreement, the contract holder either makes a lump sum deposit or makes specified periodic deposits. Jackson agrees to pay a rate of interest, which may be fixed but which is usually a floating short-term interest rate linked to an external index. Interest is paid quarterly to the contract holder. The average term for the funding agreements is one to two years. At the end of the specified term, contract holders may re-deposit the principal in another funding agreement. Jackson makes its profit on the spread between the yield on its investments and the interest rate credited to contract holders.

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 contract holder on seven to 90 days notice, and thus qualify as cash equivalents for the clients' purposes. In 2012 and 2011, there were no funding agreements terminable by the contract holder with less than 90 days notice.

Jackson is a member of the FHLBI. Membership allows Jackson access to advances from FHLBI that are collateralised by mortgage related assets in Jackson's investment portfolio. These advances are in the form of funding agreements issued to FHLBI.

Medium Term Note Funding Agreements

Jackson has also established European and global medium-term note programs. The notes offered may be denominated in any currency with a fixed or floating interest rate. Notes are issued to institutional investors by a special purpose vehicle and are secured by funding agreements issued by Jackson. Although Jackson has these programs in-force, there have been no new sales since 2008.

Distribution and Marketing

Jackson distributes products in all 50 states of the United States and in the District of Columbia, although not all products are available in all states. Operations in the state of New York are conducted through a New York insurance subsidiary. Jackson markets its retail products primarily through advice based distribution channels, including independent agents, independent broker-dealer firms, regional broker-dealers, and wirehouses, banks and registered investment advisors. Through August 2012, Jackson also marketed life insurance and fixed annuity products through its captive insurance agency.

Jackson focuses on independent distribution systems and supports its network of independent agents and advisers with education and training programs.

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Independent Agents and Broker Dealers

Jackson's subsidiary, Jackson National Life Distributors, LLC ('JNLD'), is the primary marketing and distribution organisation for Jackson's annuities. The annuity products are distributed through independent agents located throughout the United States. These approximately 20,000 appointed insurance agents or brokers at 31 December 2012, who also may represent other companies, are supported with marketing materials and multimedia presentations to help advisers choose the right solutions for their clients' individual financial situations. JNLD generally deals directly with writing agents and brokers thereby eliminating intermediaries, such as general agents. This distribution channel has enabled Jackson to generate significant volumes of business on a low, variable cost basis.

JNLD's wholesalers meet directly with independent broker dealers and financial planners and are supported by an extensive internal sales staff. At 31 December 2012, Jackson had active selling agreements with independent broker dealer organisations throughout the United States providing access to more than 58,900 appointed agents. Jackson provides training for its broker dealers and also provides them with product information and sales materials.

Regional Broker Dealers

JNLD's Regional Broker Dealer ('RBD') team provides dedicated service and support to regional brokerage firms and wirehouses. Regional broker dealers are a hybrid between independent broker dealers and wirehouses. Like representatives who work for wirehouses, financial representatives at regional broker dealers are actual employees of the firm. However, unlike wirehouses, RBD firms have limited institutional investment banking services. The RBD team develops relationships with regional firms throughout the US and provides customised materials and support to meet their specialised advisory needs.

Jackson's RBD team also provides support for the wirehouse channel, which produced £1.8 billion of premium in 2012.

Jackson's RBD team supports more than 33,800 representatives in regional broker dealers and wirehouses.

Banks, Credit Unions and Other Financial Institutions

Jackson's Institutional Marketing Group distributes annuity products through banks, credit unions and other financial institutions and through third party marketing organisations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and at 31 December 2012 had access to more than 33,200 financial institution representatives through existing relationships with banks and credit unions. Jackson has established distribution relationships with medium sized regional banks, which it believes are unlikely to develop their own insurance product capability.

Independent Broker Dealers

Jackson's retail distribution is managed by Prudential's independent broker dealer network, NPH, which is described in more detail above. NPH had 3,540 registered representatives at the end of 2012.

Institutional Products Department

Jackson markets its institutional products through its institutional products department. It has direct contacts with banks, municipalities, asset management firms and direct plan sponsors. Institutional products are distributed and marketed through intermediaries to these groups.

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Captive Agency

In connection with the acquisition of Life of Georgia in 2005, Jackson established the JNL Southeast Agency ('JNLSA'), the company's first captive agency since 1970. JNLSA was formed to help retain the Life of Georgia book of business and to create a new distribution channel for Jackson's life insurance. In conjunction with Jackson's withdrawal from retail life insurance sales, this agency was terminated in 2012.

Registered Investment Adviser

As described above Curian Capital, LLC is Jackson's registered investment adviser channel.

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

Curian's sales, not included in Jackson's premiums and deposits, totalled £1,550 million and £1,684 million in 2012 and 2011, respectively.

Factors Affecting Pricing of Products and Asset Liability Management

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

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

Jackson segregates its investment portfolio for certain investment management purposes, and as part of its overall investment strategy, into four portfolios: life and fixed annuities without market value adjustment, fixed annuities with market value adjustment, fixed index annuities and institutional liabilities. The portfolios backing life and fixed annuities with and without market value adjustments and the fixed index annuities have similar characteristics and differ primarily in duration. The portfolio backing the institutional liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the institutional portfolio is managed to permit less interest rate sensitivity and has limited exposure to mortgage backed securities. At 31 December 2012, 4 per cent of the institutional portfolio was invested in residential mortgage backed securities.

The fixed-rate products may incorporate surrender charges, market value adjustments, two-tiered interest rate structures or other limitations relating to when policies can be surrendered for cash, in order to encourage persistency. As of 31 December 2012, 70 per cent of Jackson's fixed annuity reserves had surrender penalties or other withdrawal restrictions. Substantially all of the institutional portfolio had withdrawal restrictions or market value adjustment provisions.

Fixed index annuities issued by Jackson also include an equity component that is hedged using equity options and futures contracts issued on the corresponding exchange. The equity component of

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these annuities constitutes an embedded derivative under IAS 39 'Financial Instruments: Recognition and Measurement' that is carried at fair value, as are other derivative instruments.

Guaranteed benefits issued by Jackson in connection with the sales of variable annuity contracts expose Jackson to equity risk as the benefits generally become payable when equity markets decline and contract values fall below the guaranteed amount. As discussed previously, certain of these benefits are carried at fair value under IAS 39 with changes in fair value recorded in income. Jackson hedges the tail risk associated with the equity exposure using equity options and futures contracts, which are also carried at fair value under IAS 39. Jackson hedges the economic risk associated with these contracts and, therefore, has not explicitly hedged its fair value risk. In addition, certain benefits have mortality risk and are therefore precluded from being carried at fair value. As a result of these factors, the income statement may include a timing mismatch related to changes in fair value. However, as demonstrated during the economic crisis, subsequent rebound and recent volatility in the equity markets, Jackson's hedges have effectively operated as designed.

Reserves

Except for certain non-insurance deposit-type accounts and as allowed under IFRS, Jackson uses reserves established on a grandfathered US GAAP basis as the basis for consolidation into Prudential's IFRS accounts.

For the fixed and variable annuity contracts and institutional products, the reserve is the contract holder's account value. For the immediate annuities, reserves are determined as the present value of future policy benefits. Mortality assumptions are based on the 1983 Individual Annuitant Mortality Table and the Annuity 2000 Mortality Table for newer issues. Interest rate assumptions currently range from one per cent to five and a half per cent.

The IFRS accounting for guarantees on Jackson's variable annuity contracts has a mixed measurement approach. GMWB 'not for life' contract features are fair valued under IAS 39 and current US GAAP, with a capping feature to prevent early anticipation of expected fees for guarantees. However, the GMDB and GMWB 'for life' blocks of business are accounted for under grandfathered US GAAP which does not, and is not intended to, fair value the liabilities.

For the traditional term life contracts, reserves for future policy benefits are determined using assumptions as to mortality, interest, policy persistency and expenses. Mortality assumptions are generally from 25 per cent to 160 per cent of the 1975-1980 Basic Select and Ultimate tables, depending on underwriting classification and policy duration. Interest rate assumptions range from two and one half per cent to six per cent. Persistency and expense assumptions are based on Jackson's experience.

For the interest sensitive and single premium life contracts, reserves approximate the contract holder's account value.

Reinsurance

Jackson reinsures portions of the coverage provided by its life insurance products with other insurance companies under agreements of indemnity reinsurance. Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to obtain a greater diversification of risk for the life insurer. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured. Jackson's reinsured business is ceded to numerous unaffiliated reinsurers and the amount of reserves ceded to any one reinsurer is not material to Jackson's overall financial position. Typically, the reinsurers have an AM Best Co rating of A or higher.

As a condition to the REALIC acquisition and after receipt of all required regulatory approvals, REALIC entered into three retrocession reinsurance agreements with Swiss Re. Pursuant to these

reinsurance agreements, REALIC ceded to Swiss Re on a 100 per cent coinsurance basis certain blocks of business written or assumed by REALIC. The effective date of the three retrocession agreements was 1 July 2012. In addition and pursuant to these reinsurance agreements, Jackson holds certain assets, primarily in the form of policy loans and fixed maturities, as collateral. This collateral is reported as a funds held liability.

At 31 December 2012, Jackson's largest amount ceded to one reinsurer totalled £4.3 billion, which is primarily related to the retrocession reinsurance arrangements.

Jackson typically ceded 90 per cent of level premium term products. Jackson discontinued new sales of life insurance products effective 1 August 2012.

Jackson ceded the guaranteed minimum income benefit on variable annuities to an unaffiliated reinsurer.

Policy administration

Jackson provides a high level of administrative support for both new and existing contract holders. Jackson's ability to implement new products quickly and provide customer service is supported by integrated computer systems that issue and administer complex life insurance and annuity contracts. Jackson continues to develop its fixed and variable annuity administration systems to enhance the service capabilities for both new and existing policies. The REALIC business is currently administered by several third party administrators.

PPM America

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

UK Business

Introduction

As at 31 December 2012, Prudential's UK business was structured into two business units, each focusing on its respective target customer markets. The Prudential's UK business units are Prudential UK (being the insurance operations) and M&G (being the asset management business).

In 2012, Prudential's UK business generated new business insurance premiums of £6,495 million and gross investment inflows of £34,464 million. As at 31 December 2012, M&G had £228 billion of funds under management.

Prudential UK business overview

The Life & Pensions market in the UK is mature and highly regulated. Significant regulatory change occurred in 2012 with the implementation of the Retail Distribution Review, Gender Neutral Pricing and Auto-enrolment for company pension schemes.

The UK market is also characterised by an ageing population and a concentration of wealth in the 50+ age group, many of whom have built up substantial pension funds in employer-sponsored schemes. These customers require help to convert wealth into sustainable lifetime income. For the next generation of savers, the responsibility for retirement provision has shifted substantially away from government and

employers towards the individual. These customers are typically under-funded for retirement and this creates a significant need for long term savings and retirement income products.

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

We do so by competing on a selective basis in the UK's retirement savings and income market, with a focus on writing profitable new business combined with sustainable cash generation and capital preservation, rather than pursuing top-line sales growth.

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

The combined financial strength and investment performance track record of Prudential's UK With-Profits Fund continues to provide a key source of non-price differentiation in a competitive market. Our with-profits customers benefit from the security of Prudential's large inherited estate, which was valued at £7 billion at the year-end, and provides a high degree of protection against adverse market movements. The Fund continues to provide customers with solid returns and to out-perform the FTSE All-Share Index over medium to long-term horizons. Over the last 15 years, the Fund has delivered a cumulative investment return of 184.3 per cent on investments covering policyholder liabilities. This compares favourably with other with-profits funds and the FTSE All-Share Index total return of 106.5 per cent over the same period, and, by offering customers a smoothed return, helps provide protection from the full impact of volatile market conditions. This performance shows that investing in a strong with-profits fund can produce good returns for cautious investors, in spite of the combined pressures of volatile market conditions and UK interest rates remaining at historically low levels.

Retention and management of our customer base of approximately 7 million remains a key focus for the business. We aim to maintain loyalty by continuing to improve our service year on year for both customers and intermediaries. Prudential UK's focus on continuing to deliver excellent customer service was recognised at the 2012 Financial Adviser Service Awards, where we retained our two 5-Star ratings in the Life & Pensions and Investment categories.

In 2010, Prudential UK met its cost savings target of £195 million per annum and announced further cost saving initiatives to reduce costs by £75 million per annum on a consistent basis by the end of 2013. By 31 December 2012, annual cost savings of £75 million per annum had been achieved, which was one year earlier than originally planned.

UK Products and profitability

In common with other UK long-term insurance companies, Prudential UK's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. 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 sub-fund and can be single premium (for example, Onshore Bonds) or regular premium (for example, certain pension products). Prudential UK's primary with-profits sub-fund is part of The Prudential Assurance Company Limited (PAC)'s long-term fund. The return to shareholders on virtually all Prudential UK's with-profits products is in the form of a statutory transfer to PAC shareholders' funds. This is analogous to a dividend from PAC's long-term fund, and is dependent upon the bonuses credited or declared on policies in that year. Prudential's with-profits policyholders currently receive 90 per cent of the distribution from the main with-profits

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sub-fund as bonus additions to their policies, while shareholders receive 10 per cent as a statutory transfer.

The Defined Charge Participating Sub-Fund (DCPSF) forms part of the PAC long-term fund. It comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France and the defined charge participating with-profits business reassured into PAC from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd. It also includes the portfolio of with-profits annuity policies acquired from Equitable Life in 2007. All profits in this fund accrue to policyholders in the DCPSF.

The profits from almost all of the new non-participating business accrue solely to shareholders. Such business is written in the non-profit sub-fund within PAC's long-term fund, or in various shareholder-owned direct or indirect subsidiaries. The most significant of these is Prudential Retirement Income Limited (PRIL), which writes conventional annuities including all new conventional annuities arising from vesting deferred annuity and personal pension policies in the with-profits sub-fund of PAC. There is also a substantial volume of in-force non-participating business in PAC's with-profits sub-fund and that fund's wholly owned subsidiary Prudential Annuities Limited (PAL), which is closed to new business. Profits from this business accrue to the with-profits sub-fund (WPSF). On 31 October 2012, we reinsured substantively all of the long-term insurance business of PAL to the WPSF.

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 originally 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 has resulted in the distinction between life insurance and other long-term savings products becoming less important. Pension products remain tax-advantaged within certain limits.

Further information on the UK products is provided below under 'UK Business Units Long term products'.

Distribution

Retail financial services products are distributed face to face through independent financial advisers (IFAs) and restricted advisers, or directly by mail, telephone and over the internet. IFAs dominate the advice market and offer products from a range of insurance companies selected from the whole of the market. Restricted advisers do not need to select from the whole market and are typically tied to a single insurer or a small panel of insurers. Direct and e-commerce distribution methods are generally non-advised and therefore operate on a lower-cost basis than other distribution channels. Accordingly, products distributed directly are generally more straightforward and aimed at more simple financial planning needs.

The FSA's review of the retail distribution marketplace called the Retail Distribution Review ('RDR') came into force on 31 December 2012. One of the main aims of the RDR was to increase the level of professionalism within the financial advice market. Prudential supports this aim.

The changes implemented increase the clarity with which advisory firms describe their services and charges. They stipulate that the adviser must be paid by the customer. Providers are no longer permitted to pay commission on new sales of retail investment products. Comparable rules have been introduced for group pensions business. Sales of protection business and general insurance can still attract commission. The changes have also significantly increased the requirements for firms who seek to describe themselves as independent. Major advisory firms have launched restricted advice models and the popularity of this model is expected to grow.

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A significant feature of the UK retail marketplace over the past decade has been the growth of investment platforms. From an initial concept of providing easy access for consumers and advisers to open ended investment companies (OEICs) from a range of fund managers, many models have been developed into distribution-led propositions with the objective of capturing total business flows from adviser firms, across various products.

As a result, in parallel to the overall RDR, the FSA has been paying specific attention to the role of platforms and in June 2012 published a consultation paper proposing a ban on the payment of rebates from fund managers to platforms and reconfirming their intention to introduce a ban on the payment of cash rebates to customers. The FSA acknowledged that such proposals could not be implemented at the same time as the RDR and indicated the most likely date for the implementation of these new platform rules would be 31 December 2013. A policy statement confirming the outcome of the FSA's review on platforms and introducing corresponding rules is currently expected during the second quarter of 2013.

The full impact of the RDR remains uncertain. As expected, FSA figures confirm that some IFAs chose to exit the market on the introduction of the new rules. Increasingly, others are expected to seek partnership arrangements with product providers through restricted advice models. Prudential is well placed to participate in such arrangements with partnerships already in place with a number of major advice firms

A large proportion of Prudential UK's annuity sales are made direct on a non-advised basis and will be largely unaffected by the RDR.

Prudential UK is continuing to work with the regulator, industry bodies and distributors on ways to help advisers make the transition to the new environment as it believes that a strong adviser sector is beneficial for the market, and for Prudential.

In 2010-2012, Prudential UK's new business premiums by channels are as follows:

	Year Ended 31 December		
	2012	**2011**	**2010**
	£m	**£m**	**£m**
Individual Annuities:			
Direct & Partnerships	**297**	328	593
Intermediated	**653**	241	221
Internal Vesting*	**1,456**	1,223	1,235
Total Individual Annuities	**2,406**	1,792	2,049
Other Products:			
Direct & Partnerships	**642**	654	588
Intermediated	**2,922**	2,244	2,215
Wholesale	**408**	336	945
Total Other Products	**3,972**	3,234	3,748
DWP Rebates	**115**	104	113
Total New Business Premiums	**6,493**	5,130	5,910

* Internal vesting business is classified as new business where the contracts include an open market option.

Direct and Partnerships

The direct distribution channel is primarily charged with increasing revenue from existing Prudential UK customers and retention of our existing customer base. Direct distribution channels include the telephone, mail and internet, and focus on annuities, investments, protection and health products.

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In December 2011 Prudential UK launched a direct advice service, Prudential Financial Planning (PFP). PFP offers a complete financial planning service, focused primarily on existing customers who originally came to Prudential through its direct sales force. Starting with 25 advisers recruited at the end of 2011, Prudential has steadily increased the scale of the channel through 2012; and as at 31 December 2012 it had grown to 129 advisers.

In March 2013, the ABI code of conduct on retirement choices, to which Prudential has committed, came into force. The code is designed to help customers make the most appropriate choices at retirement. Prudential's direct channel will support the requirements of the code for its pension customers.

Partnerships are primarily arrangements with other insurers whereby we offer our annuity products to their vesting pension customers.

Intermediaries

In 2012 Prudential UK consolidated its position with major intermediary firms and significantly increased sales through this channel in a challenging market. Alongside this, Prudential UK worked closely with its distribution partners in the development of their business models for the post-RDR environment and is well placed to support the new emerging models which distributors have introduced to deal with the RDR requirements.

Wholesale

In the Wholesale market, Prudential UK's aim is to continue to participate selectively in bulk and back-book buyouts using its financial strength, superior investment track record, annuitant mortality risk assessment and servicing capabilities. In line with this opportunistic approach, two bulk annuity buy-in insurance agreements were signed in 2012 totalling £408 million of new business premiums. Prudential UK will continue to maintain a strict focus on value and only participate in capital-efficient transactions that meet its return on capital requirements.

UK Business Units

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 UK's 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. Prudential UK also distributes life insurance products, primarily investment bonds, in other European countries. The volume of such business is relatively small and is included in the table below.

	Year Ended 31 December		
	2012	**2011**	**2010**
	£m	**£m**	**£m**
Pension annuities	**2,406**	1,792	2,049
Corporate pensions	**459**	399	426
Onshore bonds	**2,276**	1,779	1,660
Other products	**946**	824	830
Wholesale	**408**	336	945
Total new business premiums	**6,495**	5,130	5,910

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Of the total new business premiums of £6,493 million (2011: £5,130 million; 2010: £5,910 million), £6,286 million (2011: £4,871 million; 2010: £5,656 million) were single premiums and £207 million (2011: £259 million; 2010: £254million) were regular premiums.

Pension Annuities

Prudential UK offers individual conventional immediate annuities that are either fixed or retail price indexed (referred to as 'RPI'), where annuity payments are guaranteed from the outset, or with-profits annuities, where annuity payments are variable dependent on the investment performance of underlying assets.

A total of £2,406 million of individual annuities were sold in 2012. Of this total, £1,456 million was sold through internal vesting, that is existing Prudential UK customers with maturing pension policies. The other £950 million were sold to new customers, typically individuals with a pension maturing with another provider who chose Prudential UK to provide their annuity. Prudential UK's immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products. The primary risks to Prudential UK from immediate annuity products, therefore, are mortality improvements and credit risk.

Conventional Annuities

Prudential UK's conventional annuities include level (non-increasing), fixed increase and RPI annuities. Prudential UK's fixed increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The RPI annuities provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK Retail Prices Index. In 2012, sales of RPI annuities were £122 million (including £111 million of bulk annuities). In 2012, sales of level and fixed increase conventional annuities amounted to £1,782 million (including £297 million of bulk annuities).

With-profits Annuities

Prudential UK's with-profits annuities combine the income features of annuity products with the investment smoothing features of with-profits products and enable policyholders to obtain equity-type returns over time. In 2009, Prudential UK launched the Income Choice Annuity, which allows customers to choose an income between a defined maximum and minimum level, with the option of re-setting this every two years. It also provides an opportunity for pension income to grow based on the returns of the with-profits fund. Through this product, Prudential UK brings its product development strengths to bear while also capitalizing on people's need for protection from inflation through increasingly long periods of retirement.

Prudential is one of only a few companies in the United Kingdom which are active in the with-profits annuities market and has been operating in this market since 1991. In 2012, Prudential UK's premiums for this business were £910 million. Prudential UK has a new business market share of 76 per cent in the first nine months of 2012[(7)].

Pension Products

Prudential UK provides both corporate and individual pension products. Corporate pension products are discussed below whilst individual pension products are discussed under 'Other Products'. Pension products are tax-advantaged long-term savings products that comply with rules established by the HM Revenue and Customs ('HMRC') and are designed to supplement state-provided pensions. These

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(7) Source: ABI

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products provide policyholders with a number of options at retirement. Policyholders may elect to use part or all of their maturity benefits to purchase a pension annuity, they may choose to draw down funds without purchasing an annuity (subject to a number of rules and restrictions on the amount able to be drawn down each year), they may delay taking any benefits, or take a combination of these options. They are also permitted to take a portion as a tax-free lump sum. For drawdown products, the investment risk remains with the policyholder, payments are not guaranteed, and tend to cost more to administer. This means that the option to enter drawdown will tend to apply mainly to more sophisticated policyholders and to larger retirement funds. This, combined with the individual's own need for a secured income in retirement, means that in practice most policyholders are likely to purchase an annuity.

Prior to retirement, these products typically have minimal mortality risk to Prudential UK and are primarily considered investment products. An exception is where a guaranteed annuity option ('GAO') has been offered on the product, with an element of risk to Prudential UK both in underlying mortality and investment assumptions. Prudential UK ceased marketing GAOs in 1987, but for a minority of corporate pension schemes GAOs still apply for new members. Current liabilities for this type of business make up less than one per cent of the with-profits sub-fund as at 31 December 2012.

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

Corporate Pensions

There are two categories of corporate pension products: defined benefit and defined contribution. Prudential UK has an established defined benefit plan client base covering the small to medium-sized employer market. Prudential UK's defined contribution client base ranges from small unlisted companies to some of the largest companies in the United Kingdom as well as a number of clients in the public sector (in particular where Prudential UK offers the Additional Voluntary Contribution ('AVC') facility). Additional Voluntary Contribution plans enable employees to make additional pension contributions, either regularly or as a lump sum, to supplement their occupational pension plans. Prudential UK administers corporate pensions for over 600,000 scheme members sponsored by some of the UK's largest employers and has also built a very strong position in the provision of with-profits AVC arrangements. Prudential UK provides AVCs to 68 of the 99 Local Government Authorities in England & Wales.

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

Prudential UK offers group unit-linked policies and with-profits policies to the corporate pensions market. Prudential UK's defined contribution products are AVC plans, Group Money Purchase plans, Group Personal Pension plans, Group Stakeholder Pension plans and Executive Pension plans.

In addition, Prudential UK has a Company Pension Transfer Plan (or 'Bulk S32'), designed to accept benefits from both defined benefit and defined contribution pension schemes which are winding up (ceasing to exist or being replaced by a new type of scheme). Prudential UK also has the facility to accept enhanced transfers from deferred members of a corporate's defined benefit pensions scheme into Prudential UK Personal Pension plan where the member has received advice from an independent financial adviser (often called an enhanced transfer value exercise).

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Onshore Bonds

Prudential UK offers customers a range of investment funds to meet different risk and reward objectives. Prudential UK's main onshore bond product wrapper is the Prudential Investment Plan ('PIP'). Through this plan, based on a single premium with no fixed term, customers have the option to invest in the with-profits fund through PruFund or in a range of unit-linked investment funds.

PIP also gives financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In 2012, sales of the unit-linked option within on-shore bond wrappers, including PIP were £127 million.

Prudential Dynamic Portfolios, launched in 2010, offer advisers a choice of portfolio options to match a client's risk/reward profile as an alternative to building an individual portfolio.

Prudential UK offers a unitised and smoothed with-profits investment bond entitled PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer with a choice of Cautious or Growth funds. PruFund also offers clients an optional guarantee on the initial investment with a term from six to ten years depending on the client's requirements. PruFund is available across Prudential UK's range of tax wrappers including individual pensions, income drawdown and onshore and offshore bonds. In 2012, total new business premiums attributable to PruFund, including new business through PIP, was £1,601 million.

With-profits bonds aim to provide capital growth over the medium to long term, and access to a range of investment sectors without the costs and risks associated with direct investment into these sectors. Capital growth for the policyholder on with-profits bonds apart from PruFund is achieved by the addition of reversionary or annual bonuses, which are credited to the bond on a daily basis from investment returns achieved within PAC's long-term with-profits fund, offset by charges and expenses incurred in the fund. A final bonus may also be added when the bond is surrendered. PruFund delivers growth through a published expected growth rate, updated quarterly, and a transparent formulaic smoothing mechanism. In contrast the capital return on unit-linked bonds directly reflects the movement in the value of the assets underlying those funds. When funds invested in PAC's long-term with-profits fund are either fully or partially withdrawn, PAC may apply a market value adjustment to the amount paid out.

The sales growth across Prudential UK's with-profits range has been achieved on the back of sustained strong investment performance in its Life Fund over a number of years, reflecting the benefits of its diversified investment policy. Prudential believes that this market will continue to see further growth as investors turn to trusted and financially strong brands and products offering an element of capital protection.

Other Products

Other products comprise individual pensions, income drawdown, offshore bonds, healthcare, life insurance and equity release mortgages.

Individual Pensions

Prudential UK's individual pension range offers unit-linked and unitized with-profits products, including 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 UK designs, administers and charges for and distributes pension products. The most significant requirements involve capped charges and a low minimum contribution which must be accepted by the provider. The UK government has capped charges

at 1.5 per cent per annum of the policyholder account balance for stakeholder pensions for the first ten years, decreasing to 1 per cent thereafter, which is below the charges on personal pension products previously offered by the UK pensions industry.

As of 2012, individuals who are not already in a pension scheme, who are over 21 and below retirement age and whose earnings are over a minimum amount have had to be automatically enrolled in a pension scheme by their employer, who will be required to make contributions. These requirements were applied first to larger employers and will be rolled out gradually to medium-sized and smaller employers.

Prudential UK also provides individual personal pension products through the DWP Rebate arrangement. Under this arrangement, individuals may elect to contract out of the UK's State Second Pension (referred to as 'S2P') which was previously known as State Earnings Related Pension Scheme, administered by the UK Department of Work and Pensions. If an individual elects to contract out, then he or she will designate a pension provider, such as Prudential UK. Premiums on products sold in this manner are paid through 'rebates' from the Department of Work and Pensions, which represent the amount that would be otherwise paid into S2P. Rebate amounts are invested to provide benefits to the individual. Premiums from Department of Work and Pensions Rebates are typically reported in the first quarter of each year. The option to contract out was removed from April 2012 and no further contributions will be received, although Prudential will continue to administer in-force policies.

Income Drawdown

Given the UK's historic requirement for compulsory annuitisation by a maximum age (removed completely in April 2011), an increasingly sophisticated consumer population, and the rising incidence of second careers and semi-retirement as a result of increasing longevity, the market has seen good growth in the 'bridge' between pensions and annuities through income drawdown products. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth. In 2012, Prudential UK sold £110 million of income drawdown products.

Offshore Bonds

Prudential UK's offshore bond products are the Prudential International Investment Bond and the Prudential International Investment Portfolio offering clients access to a wide range of quoted UK investments. Prudential UK's offshore bond sales grew by 17 per cent to £310 million in 2012.

Healthcare

PruHealth was launched in 2004 as a private medical insurance provider and is backed by Prudential and Discovery of South Africa. PruHealth uses the Prudential brand and Discovery's expertise to build branded distribution and innovative product offerings in the private healthcare and protection markets. In August 2010, PruHealth acquired Standard Life Healthcare and as part of the transaction, Prudential UK reduced its shareholding in the combined PruHealth and PruProtect businesses from its previous level of 50 per cent to 25 per cent of the enlarged business.

Life Insurance Products

Prudential's UK life insurance products are predominantly pure protection (term) products, and include the PruProtect product sold through the joint venture with Discovery. PruProtect's product is focused around a core philosophy of helping people become healthier while protecting and improving the quality of their lives.

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Equity Release Mortgage

In November 2009, Prudential UK announced the decision to close its equity release operation to new business. Existing customers may, however, still draw down additional funds, subject to their overall borrowing limits.

Wholesale

Wholesale business comprises bulk annuities. Prudential UK offers bulk annuities selectively, whereby it manages the assets and accepts the liabilities of a company pension scheme. The volume of Prudential UK's bulk annuity sales is unpredictable as the business maintains a very strict focus on value and only participates in capital-efficient transactions that meet its return on capital requirements.

Reinsurance

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

Reserves

In the United Kingdom, a life insurance company's reserve and other requirements are determined by its Board, with advice from its Actuarial Function Holder, subject to minimum reserve requirements. These minimum reserve requirements are established by the rules and guidance of the FSA.

The reserves are published in annual returns to the FSA. In practice, similar provisions are included in the life insurance company's statutory accounts with limited adjustments. The Actuarial Function Holder must pay due regard to the fair treatment of policyholders in making recommendations to the company's board. The Actuarial Function Holder is required to report directly to the FSA any serious concerns regarding the company's ability to treat its customers fairly.

Prudential UK's regulatory reserving for with-profits products, as required by UK regulation, takes into account annual bonuses/annual interest credited to policyholders because these are 'attached' to the policies and are guaranteed. Realistic reserves are also calculated for with-profits products under UK regulation. These include an allowance for final bonuses based on the asset share or a prospective valuation of the policies and the cost of guarantees, smoothing and enhancements.

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

As well as the reserves, the company's assets must also cover other capital requirements set out in the FSA Prudential Sourcebook. These comprise a with-profits insurance capital component, which is a measure of the difference in the surplus assets on regulatory and realistic bases; a resilience capital requirement for entities other than PAC, which makes prudent allowance for potential future adverse movements in investment values; and the long-term insurance capital requirement, which must be held by all EU insurance companies. See 'Financial Strength of PAC's Long-term Fund' for further information on solvency and 'Realistic Financial Strength Reporting' for further information on realistic reporting.

Financial strength of PAC's with-profits fund

The PAC's with-profits fund is supported by a large inherited estate, with the free assets of the with-profits fund valued at approximately £7 billion (as at 31 December 2012), on a regulatory realistic basis. This provides the working capital required to support the fund for the long-term benefit of

current and future policyholders. The strength of the with-profits fund offers strong policyholder protection and assists in generating positive returns for both policyholders and shareholders.

The table below shows the change in the investment mix of PAC's main with-profits fund:

	2012	2011	2010
	%	%	%
UK equities	**17**	24	26
International equities	**17**	10	13
Property	**12**	13	12
Fixed Interest	**44**	44	42
Cash and other asset classes	**10**	9	7
Total	**100**	100	100

Despite a low interest rate environment and continued volatile market conditions, the with-profits sub-fund earned a return of 10.5 per cent before tax in 2012 on investments covering policyholder liabilities. The with-profits sub-fund has delivered investment returns of 184.3 per cent over 15 years for policyholder asset shares in the fund, compared with the FTSE All-share index (total return) of 106.5 per cent over the same period (figures are to 31 December 2012, before tax and charges).

Realistic Financial Strength Reporting

In accordance with the FSA Prudential Sourcebook, PAC has to demonstrate solvency on a 'realistic' valuation basis as well as the regulatory basis. In the aggregate, the basis has the effect of placing a value on the liabilities of UK with-profits contracts that reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances.

This basis makes companies' financial health more transparent to policyholders, intermediaries and regulators alike, and enables more informed choices to be made by policyholders. The PAC long-term with-profits sub-fund is strong with the inherited estate (free assets) measured on a realistic basis, valued at approximately £7 billion at the end of 2012 before deduction for the risk capital margin.

In line with FSA requirements, PAC produces an Individual Capital Assessment ('Pillar II') which is an assessment of the economic capital required to ensure that there is a high likelihood that the company can meet its liabilities as they fall due.

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

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

With-profits Products

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

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

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

PAC's board of directors, with the advice of its Actuarial Function Holder and its With-Profits Actuary, determines the amount of annual and final bonuses to be declared each year on each group of contracts.

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

- the cost of mortality risk and other guarantees (where applicable),
- the effect of taxation,
- management expenses, charges and commissions,
- the proportion of the amount determined to be distributable to shareholders, and
- the surplus arising from surrenders, non-participating business included in the with-profits fund and other miscellaneous sources.

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

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

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

In 2012, PAC declared a total surplus of £2,210 million (2011: £2,293 million) from PAC's primary with-profits sub-fund, of which £1,990 million (2011: £2,064 million) was added to with-profits policies and £220 million (2011: £229 million) was distributed to shareholders. These amounts included annual bonus rates of 3.0 per cent for Prudence Bond and 3.0 per cent for personal pensions.

The closed Scottish Amicable Insurance Fund ('SAIF') declared total bonuses in 2012 of £541 million compared to £611 million in 2011. 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.

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Surplus Assets in PAC's Long-term With-profits Fund

The assets of the main with-profits sub-fund within the long-term fund of PAC comprise the amounts that it expects to pay out to meet its obligations to existing policyholders and an additional amount used as working capital. The amount payable over time to policyholders from the with-profits sub-fund is equal to the policyholders' accumulated asset shares plus any additional payments that may be required by way of smoothing or to meet guarantees. The balance of the assets of the with-profits sub-fund is called the 'inherited estate' and has accumulated over many years from various sources.

The inherited estate, as working capital, enables Prudential UK to support with-profits business by providing the benefits associated with smoothing and guarantees, by providing investment flexibility for the fund's assets, by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus and investment policies. The size of the inherited estate fluctuates from year to year depending on the investment return and the extent to which it has been required to meet smoothing costs, guarantees and other events.

Depletion of Surplus Assets and Shareholders' Contingencies

As a proprietary insurance company, PAC is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets, represented by the unallocated surplus of with-profits funds, in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers ('the excess assets') in the long-term funds could be materially depleted over time by, for example, a significant or sustained equity market downturn, costs of significant fundamental strategic change or a material increase in the pension mis-selling provision. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Group's ability to satisfy policyholders' reasonable expectations was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

In 1998, Prudential UK stated that deducting personal pensions mis-selling costs from the inherited estate of the with-profits sub-fund would not impact Prudential UK's bonus or investment policy and it gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing.

The mis-selling review was completed on 30 June 2002 and the assurance has not applied to new business issued since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The maximum amount of capital support available under the terms of the assurance will reduce over time as claims are paid on the policies covered by it.

The bonus and investment policy for each type of with-profits policy is the same irrespective of whether or not the assurance applies. Hence removal of the assurance for new business has had no impact on policyholder returns and this is expected to continue for the foreseeable future.

During 2009, the FSA issued a policy statement confirming that certain payments of compensation and redress for events occurring after 31 July 2009 may only be paid from assets attributable to shareholders. As the pensions mis-selling review was concluded prior to this date, the requirements of the policy statement do not impact the provisions outlined above.

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The SAIF Sub-fund and Accounts

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

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

SAIF with-profits policies contain minimum levels of guaranteed benefit to policyholders. In addition, as mentioned below, certain pensions products have guaranteed annuity rates at retirement. Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations of the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency in the first instance. The directors believe that the probability of either the PAC long-term fund or the Group's shareholders' funds having to contribute to SAIF is remote.

Non-participating Business

The majority of Prudential-branded non-participating business is written in the non-profit sub-fund of PAC's long-term fund or in subsidiaries owned by Prudential UK. Since mid-2004, Prudential UK has written all of its new non-profit annuity business through Prudential Retirement Income limited ('PRIL'), from which the profits are attributed solely to shareholders. Prior to that time, certain non-profit annuity business was written through Prudential Annuities Limited ('PAL'), which is wholly owned by PAC's with-profits fund. The profits on this business are attributable to the fund and not to shareholders, although indirectly shareholders get one-ninth of additional amounts paid to policyholders through the declaration of bonuses.

The unit-linked business written by PAC and Prudential International Assurance is written with capital provided by shareholders.

Guaranteed Annuities

Prudential used to sell guaranteed annuity products in the United Kingdom and held a technical provision of £47 million as at 31 December 2012, within the main with-profits fund to honour guarantees on these products. PAC's main exposure to guaranteed annuities in the United Kingdom is through SAIF and a provision of £371 million was held in SAIF as at 31 December 2012, to honour the guarantees. As SAIF is a separate sub-fund of PAC's long-term business fund, wholly attributable to the policyholders of the fund, the movement in this provision has no impact on shareholders.

M&G

M&G is the UK and European fund manager of the Prudential Group with responsibility for investments on behalf of both internal and external clients. M&G is made up of two distinct businesses being Retail and Institutional. M&G's investment expertise covers all key asset classes, equities, fixed interest and commercial real estate, and includes a number of specialist fixed income and real estate strategies. M&G manages its own retail fund operations, funds for pensions, insurance companies and third-party entities.

It is an investment-led business with a clear focus on generating superior long-term returns for investors, whether they are third-party clients or the funds of Prudential's insurance operations. This is achieved by creating an environment that is attractive to talented investment professionals.

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Against a backdrop of continued political and macroeconomic uncertainty, M&G continues to deliver strong investment performance. Over the three years to 31 December 2012, 20 funds representing approximately 61 per cent of retail funds under management (FUM) produced first or second quartile investment returns. The performance of funds managed on behalf of institutional fixed income clients also remains extremely strong with all actively-managed mandates meeting or outperforming their benchmarks over this period.

Performance Overview

M&G has had a record-breaking year in terms of net sales, funds under management and profits.

Total net sales for the 12 months to the end of December 2012 were £16.9 billion, 25 per cent higher than the previous full year peak of £13.5 billion in 2009 and 285 per cent higher than net sales of £4.4 billion in 2011.

The strength of net flows, together with increases in equities and bond values in the year, have led to an increase of 13 per cent in total funds under management, to an all-time high of £228 billion. The FTSE All Share Index has increased by 8 per cent over the year and the sterling corporate bond index has increased by 15 per cent. Building on the strength of the net flows generated by the business over recent years, M&G was the largest retail fund manager in the UK[(8)], measured by funds under management. M&G's total UK retail FUM is £41.2 billion as noted by the Investment Management Association at the end of December 2012.

This caps a decade of extremely strong growth for M&G. Since 2003 net fund sales have increased at an annual compound rate of 32 per cent and external client assets have grown at an annual compound rate of 19 per cent. Over this period underlying profit has grown at an annual rate of 22 per cent.

Retail

In the retail market, M&G operates a single fund range from the UK which it distributes both locally and internationally through increasingly diverse channels. Assets sourced from investors outside the UK now account for 29 per cent of M&G's total retail FUM.

Its reputation for delivering superior long-term investment returns and a high standard of client service enabled M&G to attract a record level of net fund sales in the retail market in 2012. Excluding the results of our South African associate company, where our shareholding reduced from 75 per cent to 49.99 per cent during 2012, total net sales were £8.2 billion. This is 15 per cent higher than their previous high of £7.2 billion in 2010.

In the UK, M&G's core market, net sales totalled £3.1 billion, 30 per cent lower than the previous year but still sufficiently high to rank M&G as the top selling house for the year. M&G has ranked first for both net and gross fund sales in the UK for four consecutive calendar years, an unprecedented achievement. Fund sales slowed in the second half as a direct consequence of a decision in July to limit flows of new money into two of our best-selling sterling corporate bond funds to ensure continued flexibility in the management of the funds. We expect UK net sales to continue to slow in 2013.

By contrast, net fund sales in mainland Europe increased sharply. Following a minor net outflow in 2011, the business generated a record £5.2 billion of net sales representing 67 per cent of total retail net sales in 2012. Over the year M&G saw retail assets sourced from European clients grow by 75 per cent to £14.4 billion (2011: £8.2 billion). Today M&G has offices in 15 different countries and its retail funds are registered for sale in 20 jurisdictions.

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(8) Source: Investment Management Association, data as at end-December 2012.

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A core pillar of M&G's retail business is to offer a diversified range of investment funds and so be well-placed for changes in investor trends. The demand for conservatively managed portfolios for most of 2012 saw strong inflows into the M&G Optimal Income Fund, a highly flexible international fixed income fund, and into the M&G Global Dividend Fund. In Europe, Optimal Income was the fourth best selling fund, while Global Dividend ranked ninth over the year to end of December 2012 and was the top selling cross border Equity fund in 2012[9].

No fewer than 10 of M&G's retail funds, across the major asset classes of fixed income, equities and real estate, each attracted net sales of at least £100 million during the 12 month period.

The £8.2 billion of net retail inflows in the UK and Europe were partially off-set by a £0.4 billion net outflow from funds managed by M&G's associate entity in South Africa. These redemptions were entirely from the PPM South Africa Dividend Income Fund which was closed on 31 March 2012 ahead of the implementation of new tax legislation on 1 April 2012 which would have had a materially adverse impact on the treatment of the distribution made by the fund to its investors. Fund flows into other retail funds of the South African business have been positive.

Institutional

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

The institutional business attracted a record level of net funds in 2012, predominantly into fixed income strategies on the strength of its outstanding record of outperformance. At £9.0 billion, net inflows were 50 per cent higher than the previous best of £6.0 billion in 2009. The 2012 inflows include a single £7.6 billion mandate which is expected to be partially or wholly redeemed within the next 24 months.

M&G continues to grow its business with external institutional clients, including the provision of alternatives to bank lending. The M&G UK Companies Financing Fund, a loan facility for medium-sized companies launched in the wake of the 2008 credit crisis, has increased its total commitments to £930 million across 11 individual loans. During the year, loans were made to three new clients, while a fourth advance went to an existing borrower.

Other innovations for third-party clients include a series of investment strategies to manage long-term inflation-linked liabilities. The business successfully launched the M&G Inflation Opportunities Fund and the M&G Debt Opportunities Fund, which complement the existing M&G Secured Property Income Fund, a portfolio of long-lease properties with inbuilt inflation-linked increases. This last fund, which has total investor commitments of £1.3 billion, has delivered an annualised return of 7 per cent above the retail prices index (RPI) over the past three years.

In infrastructure, Infracapital, M&G's unlisted infrastructure equity division, led a consortium (comprising Infracapital and other parties independent of Prudential) in the acquisition of a 90 per cent interest in Veolia Environnement S.A.'s ("Veolia") UK regulated water business (now renamed Affinity Water). Affinity Water is the largest regulated water-only company in the UK by turnover. The acquisition is the first investment for Infracapital Partners II LP, which has current commitments of £358 million.

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(9) Source: SimFund Global. Data as at December 2012 in EUR. Based on estimated net sales of funds classed as fund market 'International' (registered for sale in more than 5 countries). Excludes Money Market and Alternative funds.

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

	At 31 December		
	2012	**2011**	**2010**
	£bn	**£bn**	**£bn**
Retail fund management	**55**	44	42
Institutional fund management	**57**	48	47
Internal fund management	**116**	109	109
Total	**228**	201	198

Prudential Capital

Prudential Capital manages the Group's balance sheet for profit by leveraging Prudential's market position. This business has three strategic objectives: (i) to provide professional treasury services to the Prudential Group; (ii) to operate a first-class wholesale and capital markets interface; and (iii) to realise profitable opportunities within a tightly controlled risk framework. Prudential Capital generates revenue by providing bridging finance, managing investments and operating a securities lending and cash management business for the Prudential Group and its clients.

Markets have remained difficult and volatile in 2012, and as a result the business remains focused on liquidity across the Prudential Group, management of the existing asset portfolio and conservative levels of new investment. Prudential Capital has continued to invest in developing its capabilities, by seeking to maintain the dynamism and flexibility necessary to ensure that the treasury and wholesale services remain robust in a period of increased regulatory change, and to identify and realise opportunities for profit within acceptable risk parameters. Prudential Capital is committed to working closely with other business units across the Prudential Group to exploit opportunities and increase value creation for Prudential as a whole.

Prudential Capital has a diversified earnings base derived from its portfolio of secured loans, debt investments and the provision of wholesale markets services.

Group Risk Framework

Risk Management

Introduction

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

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

Risk Oversight

Group risk appetite

(Audited)

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

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

a. the volatility of earnings is consistent with the expectations of stakeholders;

b. the Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks; and

c. earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies.

The two measures used to monitor the volatility of earnings are European Embedded Value (EEV) operating profit and International Financial Reporting Standards (IFRS) operating profit, although EEV and IFRS total profits are also considered.

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

Capital requirements: the limits aim to ensure that:

a. the Group meets its internal economic capital requirements;

b. the Group achieves its desired target rating to meet its business objectives; and

c. supervisory intervention is avoided.

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

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

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Risk exposures

(Audited)

The Group Risk Framework deploys a common risk language, allowing meaningful comparisons to be made between different business units. Risks are broadly categorised as shown below.

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

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Financial risks

a Market risk

(i) Equity risk

(Audited)

In the UK business, most of Prudential's equity exposure is incurred in the with-profits fund, which includes a large inherited estate estimated at £7.0 billion as at 31 December 2012 (31 December 2011: £6.1 billion). This can absorb market fluctuations and protect the fund's solvency. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy.

In Asia Prudential's shareholder exposure to equities relates to revenue from unit-linked products and, from a capital perspective, to the effect of falling equity markets on the with-profits businesses.

In the US, where we are a leading provider of variable annuities, there are risks associated with the guarantees embedded in our products. We provide guaranteed minimum death benefits (GMDB) on substantially all policies in this class, guaranteed minimum withdrawal benefits (GMWB) on a significant proportion of the book, and guaranteed minimum income benefits (GMIB) on only 3 per cent. To protect the shareholders against the volatility introduced by these embedded options, we use both a comprehensive hedging programme and reinsurance. The GMIB is no longer offered, with existing coverage being reinsured.

The Jackson IFRS shareholders' equity and US statutory capital are sensitive to the effects of policyholder behaviour on the valuation of GMWB guarantees, but to manageable levels.

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

It is our philosophy not to compete on price; rather, we seek to sell at a price sufficient to fund the cost we incur to hedge or reinsure our risks and to achieve an acceptable return for our shareholders.

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

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

(ii) Interest rate risk

(Audited)

Interest rate risk arises from Prudential's investments in long-term debt and fixed income securities, and also exists in policies that carry investment guarantees on early surrender or at maturity, where claim values can become higher than the value of backing assets as a result of rises or falls in interest rates.

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In Asia, the exposure to interest rate risk arises from the guarantees of some non-unit-linked investment products. This exposure arises because it may not be possible to hold assets which will provide cash flows to match exactly those relating to policyholder liabilities. This results in a mismatch due to the duration and uncertainty of the liability cash flows and the lack of sufficient assets of a suitable duration. While this residual asset/liability mismatch risk can be managed, it cannot be eliminated.

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

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

(iii) Foreign exchange risk

(Audited)

Prudential principally operates in the UK, the US and in Asia. The geographical diversity of its businesses means that Prudential is inevitably subject to the risk of exchange rate fluctuations. Prudential's international operations in the US and Asia, which represent a significant proportion of its operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements when results are expressed in pounds sterling.

The Group retains revenues locally to support the growth of the Group's business and capital is held in the local currency of the business to meet local regulatory and market requirements, accepting the balance sheet translation risks this can produce. However, in cases where a surplus arising in an overseas operation supports Group capital or shareholders' interest (ie remittances), this exposure is hedged if it is economically optimal to do so. The Group does not have appetite for significant shareholder exposures to foreign exchange risks in currencies outside the local territory. Currency borrowings, swaps and other derivatives are used to manage exposures.

b Credit risk

(Audited)

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

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The Group's balance sheet held the following total investments at 31 December 2012.

	2012				2011
	Participating funds	Unit-linked and variable annuities	Shareholder-backed	Total Group	Total Group
	£bn	£bn	£bn	£bn	£bn
Debt securities	62.0	9.5	68.6	140.1	124.5
Equity	25.1	73.9	1.0	100.0	87.3
Property investments	8.7	0.6	1.6	10.9	10.8
Mortgage loans	1.3		4.8	6.1	5.7
Other loans	1.4		4.3	5.7	4.0
Deposits	9.5	1.4	1.8	12.7	10.7
Other investments	4.7		3.2	7.9	7.6
Total	112.7	85.4	85.3	283.4	250.6

The table below presents the balances of investments related to shareholder-backed operations at 31 December 2012.

	2012	2011
	£bn	£bn
Shareholder-backed investments:		
Asia life	8.7	7.1
UK life	31.3	28.5
US life	42.0	34.0
Other	3.3	3.8
Total	85.3	73.4

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

(i) Debt portfolio

(Audited)

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

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The Group's total debt securities portfolio on an IFRS basis comprised the following at 31 December 2012:

	2012				2011
	Participating funds	Unit-linked and variable annuities*	Shareholder-backed	Total Group	Total Group
	£bn	**£bn**	**£bn**	**£bn**	**£bn**
Insurance operations:					
UK	**50.5**	**6.3**	**27.1**	**83.9**	78.0
Jackson National Life			**33.0**	**33.0**	27.0
Asia long-term business	**11.5**	**3.2**	**6.7**	**21.4**	17.7
Other operations			**1.8**	**1.8**	1.8
Total	**62.0**	**9.5**	**68.6**	**140.1**	124.5

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

UK

The UK's debt portfolio on an IFRS basis is £83.9 billion as at 31 December 2012, including £50.5 billion within the UK with-profits fund. Shareholders' risk exposure to the with-profits fund is limited as the solvency is protected by the large inherited estate. Outside the with-profits fund there is £6.3 billion in unit-linked funds where the shareholders' risk is limited, with the remaining £27.1 billion backing the shareholders' annuity business and other non-linked business (of which 75 per cent is rated AAA to A-, 23 per cent BBB and 2 per cent non-investment grade). The UK shareholder-backed portfolio did not experience any default losses in 2012.

US

At 31 December 2012 Jackson's fixed income debt securities portfolio consisted of:

Summary	**2012**	**2011**
	£bn	**£bn**
Corporate and government security and commercial loans:		
Government	**4,126**	2,163
Publicly traded and SEC Rule 144A securities[note]	**19,699**	16,281
Non-SEC Rule 144A securities	**3,542**	3,198
Total	**27,367**	21,642
Residential mortgage-backed securities	**2,400**	2,591
Commercial mortgage-backed securities	**2,639**	2,169
Other debt securities	**587**	620
Total US debt securities	**32,993**	27,022

Note

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

Of the £23.2 billion of corporate debt, 95 per cent is investment grade. Concentration risk within the corporate debt portfolio is low, with the top ten holdings accounting for approximately 8 per cent of the portfolio. Our largest sector exposures in the investment grade corporate debt portfolio are Energy

and Utilities at 15 per cent and 13 per cent, respectively. We actively manage the portfolio and will sell exposures as events dictate.

Within the RMBS portfolio of £2.4 billion, the portion guaranteed by the US government sponsored agencies is 57 per cent. The CMBS portfolio of £2.6 billion is performing strongly, with 40 per cent of the portfolio rated AAA and less than 2 per cent rated below investment grade. The entire portfolio has an average credit enhancement level of 31 per cent. This level provides significant protection, since it means the underlying collateral has to incur a 31 per cent loss, net of recoveries, before our holding is at risk.

Jackson's debt securities experienced total credit-related losses in 2012 of £47 million (2011: £52 million). This includes a loss net of recoveries of £10 million (2011: gains of £10 million) on credit-related sales of impaired bonds. IFRS write-downs on debt securities were £37 million (2011: £62 million). Of this amount of write-downs, £8 million (2011: £21 million) was in respect to RMBS securities. In addition to the amounts for debt securities, there were £5 million (2011: £28 million) of write-downs on Jackson's commercial mortgage loan portfolio. In 2012 and 2011, Jackson did not experience any defaults on its debt securities.

The impairment process reflects a review of every bond and security in our portfolio. Our accounting policy requires us to book full mark to market losses on impaired securities through our balance sheet. However, we would expect only a proportion of these losses eventually to turn into defaults, and some of the impaired securities to recover in price over time.

Unrealised gains and losses on debt securities in the US

Jackson's net unrealised gains from debt securities were £2,807 million at 31 December 2012, compared to £2,057 million at 31 December 2011. The gross unrealised loss position was £178 million at 31 December 2012 (31 December 2011: £246 million). Gross unrealised losses on securities priced at less than 80 per cent of face value totalled £53 million at 31 December 2012 compared to £158 million at 31 December 2011.

Asia

Asia's debt portfolio totalled £21.4 billion at 31 December 2012. Of this, approximately 69 per cent was in unit-linked and with-profits funds with minimal shareholders' risk. The remaining 31 per cent is shareholder exposure and is invested predominantly (65 per cent) in investment grade bonds. The Asian portfolio has performed very well, and did not experience any default losses in 2012.

Asset management

The debt portfolio of the Group's asset management operations of £1.8 billion as at 31 December 2012 is principally related to Prudential Capital operations. Of this amount £1.5 billion were rated AAA to A- by S&P or Aaa by Moody's.

(ii) Group sovereign debt exposure

(Audited)

Sovereign debt represented 15 per cent or £10.4 billion of the debt portfolio backing shareholder business (excluding unit-linked business) at 31 December 2012 (2011: 16 per cent and £9.2 billion respectively). 38 per cent of this was rated AAA and 92 per cent investment grade (2011: 43 per cent and 94 per cent respectively). Of the Group's holdings in Continental Europe of £564 million, 79 per cent was AAA rated (2011: £690 million and 87 per cent respectively). Shareholder exposure to the Eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) is £52 million

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(2011: £44 million). The Group does not have any sovereign debt exposure to Greece, Portugal or Ireland.

The exposure of the Group's shareholder and with-profits funds to sovereign debt (including credit default swaps that are referenced to sovereign debt) at 31 December 2012 is as follows.

	Shareholder sovereign debt	With-profits sovereign debt
	£m	£m
Continental Europe		
Italy	43	52
Spain	1	33
	44	85
Germany	598	602
Other Europe (principally Isle of Man and Belgium)	48	62
	690	749
United Kingdom	3,254	2,801
United States	2,448	2,615
Other, predominantly Asia	2,850	332
Total	9,242	6,497

(iii) Exposure to bank debt securities

(Audited)

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

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

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

Of the £68.6 billion of debt securities backing shareholder business, excluding holdings attributable to external holders of consolidated unit trusts, 3 per cent or £2.2 billion was in Tier 1 and Tier 2 hybrid bank debt. A further £3.2 billion was in the form of senior debt.

In terms of shareholder exposures to the bank debt of PIIGS, Prudential held £260 million at 31 December 2012 (31 December 2011: £328 million). This comprised £130 million of covered bonds, £93 million senior debt, £3 million Tier 1 debt and £34 million Tier 2 debt. There was no direct exposure to Greek banks.

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The Group held the following direct exposures to banks' debt securities of shareholder-backed business at 31 December 2012.

	Bank debt securities shareholder-backed business						
	Senior debt			Subordinated debt			
	Covered	Senior	Total senior debt	Tier 2	Tier 1	Total subordinated debt	31 Dec 2011 Total
	£m	£m	£m	£m	£m	£m	£m
Portugal		24	24				24
Ireland		13	13				13
Italy		11	11	56	14	70	81
Greece							
Spain	107	11	118	90	2	92	210
	107	59	166	146	16	162	328
Austria				9		9	9
Belgium							
France	2	34	36	78	35	113	149
Germany		28	28	1		1	29
Luxembourg							
Netherlands		7	7	81	64	145	152
United Kingdom	228	145	373	615	95	710	1,083
Total Europe	337	273	610	930	210	1,140	1,750
United States		1,362	1,362	352	2	354	1,716
Other, predominantly Asia		246	246	562	33	595	841
Total	337	1,881	2,218	1,844	245	2,089	4,307

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In addition to the exposures held by the shareholder-backed business, the Group held the following banks' securities at 31 December 2012 within its with-profits funds.

	Bank debt securities participating funds						
	Senior debt			Subordinated debt			
	Covered	Senior	Total senior debt	Tier 2	Tier 1	Total subordinated debt	31 Dec 2011 Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Portugal		**7**	**7**				**7**
Ireland							
Italy		**45**	**45**	**49**	**2**	**51**	**96**
Greece	**5**		**5**				**5**
Spain	**137**		**137**	**1**		**1**	**138**
	142	**52**	**194**	**50**	**2**	**52**	**246**
Austria							
Belgium							
France		**80**	**80**	**47**	**17**	**64**	**144**
Germany		**7**	**7**				**7**
Luxembourg		**7**	**7**				**7**
Netherlands		**80**	**80**	**14**	**28**	**42**	**122**
United Kingdom	**319**	**385**	**704**	**772**	**74**	**846**	**1,550**
Total Europe	**461**	**611**	**1,072**	**883**	**121**	**1,004**	**2,076**
United States		**1,378**	**1,378**	**396**	**278**	**674**	**2,052**
Other, predominantly Asia	**1**	**384**	**385**	**341**	**20**	**361**	**746**
Total	**462**	**2,373**	**2,835**	**1,620**	**419**	**2,039**	**4,874**

(iv) Other possible impacts of a Eurozone crisis

(Audited)

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

In respect of operational risks, Prudential has strong investment operations, counterparty risk and change management capabilities and Prudential is confident in its ability to manage the transition to a new Eurozone regime if events require it to do so.

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(v) Loans

(Audited)

Of the total Group loans of £11.8 billion at 31 December 2012, the following are held by shareholder-backed operations.

	2012 £bn			2011 £bn		
	Mortgage loans	Other loans	Total	Mortgage loans	Other loans	Total
Asia insurance operations[(i)]		**0.4**	**0.4**		0.4	0.4
US insurance operations[(ii)]	**3.5**	**2.7**	**6.2**	3.6	0.6	4.2
UK insurance operations[(iii)]	**1.3**		**1.3**	1.1		1.1
Asset management operations[(iv)]		**1.2**	**1.2**		1.3	1.3
Total loans held by shareholder-backed operations	**4.8**	**4.3**	**9.1**	4.7	2.3	7.0

Notes

(i)
The majority of Asia insurance operations loans are commercial loans held by the Malaysian operation that are rated investment grade by two local rating agencies.

(ii)
The US insurance operations held £6.2 billion of loans, comprising £3.5 billion of commercial mortgage loans and £2.7 billion of policy loans. Approximately £1.8 billion of the policy loans are held as collateral related to the three reinsurance treaties with Swiss Re, which are offset by a funds withheld liability. These loans are carried at fair value. All other loans are accounted for at amortised cost, less any impairment. All commercial mortgage loans held by US insurance operations are collateralised by properties. The US commercial mortgage loan portfolio does not include any single-family residential mortgage loans and therefore is not exposed to the risk of defaults associated with residential sub-prime mortgage loans. Jackson incurred write downs of £5 million on its commercial mortgage book (2011: write downs of £28 million).

(iii)
The majority of mortgage loans held by UK insurance operations are mortgage loans collateralised by properties.

(iv)
Relates to bridging loan finance managed by Prudential Capital.

(vi) Counterparty Credit Risk

(Audited)

The Group enters into a variety of exchange traded and over-the-counter derivative financial instruments, including futures, options, forward currency contracts and swaps such as interest rate swaps, cross-currency swaps, swaptions and credit default swaps.

All over-the-counter derivative transactions, with the exception of some Asian transactions, are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual Group

entities and relevant counterparties in place under each of these market master agreements.

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

c Insurance risk

(Audited)

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

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other industry players, the profitability of Prudential's businesses depends on a mix of factors including mortality and morbidity levels and trends, persistency, investment performance, unit cost of administration and new business acquisition expenses.

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

Prudential's morbidity risk is mitigated by appropriate underwriting and use of reinsurance and the morbidity assumptions reflect recent experience and expectation of future trends for each relevant line of business.

Prudential's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Persistency risk is mitigated by appropriate training and sales processes and managed proactively post sale. Where appropriate, allowance is also made for the relationship either assumed or historically observed between persistency and investment returns, and for the resulting additional risk.

d Liquidity risk

(Audited)

The parent company has significant internal sources of liquidity which are sufficient to meet all of its expected requirements for the foreseeable future without having to make use of external funding. In aggregate the Group has £2.1 billion of undrawn committed facilities, expiring between 2013 and 2017. In addition, the Group has access to liquidity via the debt capital markets. Prudential also has in place an unlimited commercial paper programme and has maintained a consistent presence as an issuer in this market for the last decade. Liquidity uses and sources have been assessed at the Group and at a business unit level under base case and stressed assumptions. The liquidity resources available and the subsequent Liquidity Coverage Ratio are regularly monitored and have been assessed to be sufficient under both sets of assumptions.

Non-financial risk

(Unaudited)

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

Prudential is exposed to operational risk through the course of running its business. It is dependent on the successful processing of a large and complex number of transactions, utilising various IT applications and platforms, across numerous and diverse products. It also operates under the ever evolving requirements set out by different regulatory and legal regimes (including tax), as well as utilising a significant number of third parties to distribute products and to support business operations.

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

Prudential has an operational risk management framework in place that facilitates both the qualitative and quantitative analysis of operational risk exposures. The output of this framework, in

particular management information on key operational risk and control assessments, scenario analysis, internal incidents and external incidents, is reported by the business units and presented to the Group Operational Risk Committee. This information also supports business decision-making and lessons-learned activities; the ongoing improvement of the control environment; and determination of the adequacy of Prudential's corporate insurance programme.

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

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

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

Capital management

Regulatory capital (IGD)

(Audited)

Prudential is subject to the capital adequacy requirements of the European Union Insurance Groups Directive (IGD) as implemented by the Financial Services Authority (FSA) in the UK. The IGD capital adequacy requirements involve aggregating surplus capital calculated on a FSA consistent basis for regulated subsidiaries, from which Group borrowings, except those subordinated debt issues that qualify as capital, are deducted. No credit for the benefit of diversification is permitted under this approach.

Prudential's capital position remains strong. Prudential has continued to place emphasis on maintaining the Group's financial strength through optimising the balance between writing profitable new business, conserving capital and generating cash. Prudential estimates that its IGD capital surplus is £5.1 billion at 31 December 2012 (before taking into account the 2012 final dividend), with available capital covering its capital requirements 3.0 times. This compares to a capital surplus of £4.0 billion at the end of 2011 (before taking into account the 2011 final dividend).

The movements in 2012 mainly comprise:

- Net capital generation mainly through operating earnings (in-force releases less investment in new business, net of tax) of £2.5 billion;

Offset by:

- Negative impact arising from market movements estimated at £0.2 billion;

- Final 2011 dividend of £0.5 billion and interim 2012 dividend of £0.2 billion;

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External financing costs and other central costs, net of tax, of £0.4 billion; and

Negative impact arising from foreign exchange movements of £0.1 billion.

IGD surplus represents the accumulation of surpluses across all of our operations based on local regulatory minimum capital requirements with some adjustments, pursuant to the requirements of Solvency I. The calculation does not fully adjust capital requirements for risk nor does it capture the true economic value of assets. Global regulatory developments, such as Solvency II and ComFrame, aim to ensure that the calculation of regulatory surplus continues to evolve over time into a more meaningful economic measure.

There is broad agreement that ultimately it would be beneficial to replace the IGD regime with a regime that would be more risk based. Solvency II was supposed to provide such a framework but we now know that it will not be implemented before 31 December 2015. The structure of the Group and the approach we have taken to managing our risks, with a sizeable credit reserve in the UK annuity book, a strong inherited estate in UK with profits and the relatively low risk nature of our asset management and Asian operations, together with a high level of IGD surplus means we have positioned ourselves well for future regulatory developments and stresses to our business.

(Unaudited)

In March 2013, we have agreed with the FSA to amend the calculation of the contribution Jackson makes to the Group's IGD surplus. Until now, the contribution of Jackson to the reported IGD was based on an intervention level set at 75 per cent of US Risk Based Capital Company Action Level (CAL). Going forward, the contribution of Jackson to IGD surplus will equal the surplus in excess of 250 per cent of CAL. This is more in line with the level at which we currently report free surplus, which we have set at 235 per cent of CAL. In the absence of an agreed Solvency II approach, we believe that this change makes the IGD surplus a more meaningful measure and one that is more closely aligned with economic reality. The revised IGD surplus calculation has no impact on the way that the US business is managed or regulated locally.

(Unaudited)

On this revised basis, the IGD surplus at 28 February 2013 is estimated at £4.4 billion[10] (equivalent to a capital cover of 2.5 times) which includes the £0.4 billion of subordinated debt raised in January 2013 and is after deducting £1.3 billion in respect of the Jackson change from 75 per cent to 250 per cent of CAL.

Prudential continues to have further options available to manage available and required capital. These could take the form of increasing available capital (for example, through financial reinsurance) or reducing required capital (for example, through the mix and level of new business) and the use of other risk mitigation measures such as hedging and reinsurance. A number of such options were utilised through the last financial crisis in 2008 and 2009 to enhance the Group's IGD surplus. One such arrangement allowed the Group to recognise a proportion of the shareholder's interest in future transfers from the UK's with-profits business and this remained in place, contributing £0.36 billion to the IGD at 31 December 2012. We will phase this out in two equal steps, reducing the credit taken to £0.18 billion from January 2013 and we expect to take zero credit from January 2014.

In addition to its strong capital position, on a statutory (Pillar 1) basis, the total credit reserve for the UK shareholder annuity funds also protects its capital position in excess of the IGD surplus. This

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(10) The estimated position at 28 February 2013 allows for economic conditions and surplus generation since 31 December 2012 and is stated before the final dividend and the effect of the Thanachart acquisition and after allowing for a reduction in Jackson's contribution to IGD surplus of £1.3 billion.

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credit reserve as at 31 December 2012 was £2.1 billion. This credit risk allowance represents 40 per cent of the bond portfolio spread over swap rates, compared to 33 per cent as at 31 December 2011.

Stress testing

(Unaudited)

As at 31 December 2012, stress testing of our IGD capital position to various events has the following results:

- An instantaneous 20 per cent fall in equity markets from 31 December 2012 levels would reduce the IGD surplus by £450 million;
- A 40 per cent fall in equity markets (comprising an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four-week period) would reduce the IGD surplus by £950 million;
- A 100 basis points reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £850 million*; and
- Credit defaults of ten times the expected level would reduce IGD surplus by £700 million.

* The impact of the 100 basis points reduction in interest rates is exacerbated by the current regulatory permitted practice used by Jackson, which values all interest rate swaps at book value rather than fair value for regulatory purposes. At 31 December 2012, removing the permitted practice would have increased reported IGD surplus by £0.3 billion. As at 31 December 2012, it is estimated that a 100 basis point reduction in interest rates (subject to a floor of zero) would have resulted in an IGD surplus of £4.9 billion, excluding the permitted practice. The effect of the revised calculation of Jackson's contribution to IGD surplus as at 31 December 2012 would have been to increase the sensitivity to equity market falls by approximately £50 million.

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

Prudential also uses an economic capital assessment to monitor its capital requirements across the Group, allowing for realistic diversification benefits and continues to maintain a strong position. This assessment provides valuable insights into its risk profile.

Solvency II and other global regulatory developments

(Unaudited)

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The Solvency II Directive, which sets out the new framework, was formally approved by the Economic and Financial Affairs Council in November 2009. The new approach is based on the concept of three pillars minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

Specifically, Pillar 1 covers the quantitative requirements around own funds, valuation rules for assets and liabilities and capital requirements. Pillar 2 provides the qualitative requirements for risk management, governance and controls, including the requirement for

insurers to submit an Own Risk and Solvency Assessment which will be used by the regulator as part of the supervisory review process. Pillar 3 deals with the enhanced requirements for supervisory reporting and public disclosure.

A key aspect of Solvency II is that the assessment of risks and capital requirements are intended to be aligned more closely with economic capital methodologies and may allow Prudential to make use of internal economic capital models if approved by the relevant supervisory authority.

Representatives from the European Parliament, the European Commission and the Council of the European Union are currently discussing the Omnibus II Directive which, once approved, will amend

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certain aspects of the original Solvency II Directive. In addition the European Commission is continuing to develop, in consultation with stakeholders including industry, the detailed rules that will complement the high-level principles of the Directive, referred to as 'implementing measures'. The Omnibus II Directive is not currently scheduled to be finalised until late 2013, while the implementing measures cannot be finalised until after Omnibus II.

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

The delays in finalising the Omnibus II Directive and implementing measures are expected to result in a deferral of the Solvency II implementation date for firms beyond the previously anticipated date of 1 January 2014. At this stage, it remains unclear exactly when Solvency II will come into force, although a deferral until 1 January 2016 or beyond appears likely.

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

Over the coming months Prudential will remain in regular contact with the FSA as it continues to engage in the 'pre-application' stage of the approval process for the internal model. In addition, Prudential also expects to engage in the initial stage of the FSA's proposed 'Individual Capital Adequacy Standards Plus (ICAS+)' regime, which will ultimately enable its UK insurance entities to leverage the developments made in relation to the Solvency II internal model for the purpose of meeting existing ICAS regime.

Currently there are also a number of other prospective global regulatory developments which could impact the way in which Prudential is supervised in its many jurisdictions. These include the Dodd-Frank Act in the US, the work of the Financial Stability Board (FSB) on Globally Systemically Important Financial Institutions (G-SIFIs) and the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) being developed by the International Association of Insurance Supervisors (IAIS).

The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States that, among other reforms to financial services entities, products and markets, may subject financial institutions designated as systemically important to heightened prudential and other requirements intended to prevent or mitigate the impact of future disruptions in the US financial system, The full impact of the Dodd-Frank Act on Prudential's businesses is not currently clear, however, as

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many of its provisions have a delayed effectiveness and/or require rulemaking or other actions by various US regulators over the coming years.

As part of a global initiative to identify G-SIFIs, in May 2012, the IAIS published proposed assessment methodology for designating Globally Systemically Important Insurers (G-SIIs). For those groups that are designated by the FSB as G-SII then additional policy measures including enhanced supervision, introduction of recovery and resolution plans and higher loss absorbency requirements could be proposed. Further detail of the proposals is expected during 2013 and implementation is likely to be over a period of years. Furthermore, the FSA is considering the designation of Domestically Systemically Important Insurer (DSII) for those UK insurers that are significant in UK terms. It is not yet clear what the impact of this designation may be.

ComFrame is also being developed by the IAIS to provide common global requirements for supervision of insurance groups. The framework is designed to develop common principles for supervision and so may increase the focus of regulators in some jurisdictions. It is also possible that some prescriptive requirements, including group capital, could be proposed. Further clarity on ComFrame is expected during the second half of 2013.

Capital allocation

(Unaudited)

Prudential's approach to capital allocation is to attain a balance between risk and return, investing in those businesses that create shareholder value. In order to efficiently allocate capital, Prudential measures the use of, and the return on, capital.

Prudential uses a variety of metrics for measuring capital performance and profitability, including traditional accounting metrics and economic returns. Capital allocation decisions are supported by this quantitative analysis, as well as strategic considerations.

The economic framework measures risk adjusted returns on economic capital, a methodology that ensures meaningful comparison across the Group. Capital utilisation, return on capital and new business value creation are measured at the product level as part of the business planning process.

Risk mitigation and hedging

(Unaudited)

Prudential manages its actual risk profile against its tolerance of risk. To do this, Prudential maintains risk registers that include details of the risks Prudential has identified and of the controls and mitigating actions it employs in managing them. Any mitigation strategies involving large transactions such as a material derivative transaction involving shareholder business are subject to review at Group level before implementation.

Prudential uses a range of risk management and mitigation strategies. The most important of these include: adjusting asset portfolios to reduce investment risks (such as duration mismatches or overweight counterparty exposures); using derivatives to hedge market risks; implementing reinsurance programmes to manage insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.

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RISK GOVERNANCE

Principles and objectives

Risk is defined as the uncertainty that Prudential faces in successfully implementing its strategies and objectives. This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of Prudential.

The control procedures and systems established within the Group are designed to manage rather than eliminate the risk of failure to meet business objectives. They can only provide reasonable and not absolute assurance against material misstatement or loss and focus on aligning the levels of risk-taking with the achievement of business objectives.

Material risks will only be retained where this is consistent with Prudential's risk appetite framework and its philosophy towards risk-taking. The Group's current approach is to retain such risks where doing so contributes to value creation and the Group is able to withstand the impact of an adverse outcome, and has the necessary capabilities, expertise, processes and controls to appropriately manage the risk.

In keeping with this philosophy, the Group has five objectives for risk and capital management which are as follows:

- Framework to design, implement and maintain a capital management and risk oversight framework, which is consistent with the Group's risk appetite and philosophy towards risk taking;

- Monitoring to establish a 'no surprises' risk management culture by identifying the risk landscape, assessing and monitoring risk exposures and understanding change drivers;

- Control to implement suitable risk mitigation strategies and remedial actions where exposures are deemed inappropriate, and to manage the response to potentially extreme events;

- Communication to effectively communicate the Group risk, capital and profitability position to both internal and external stakeholders; and

- Culture to foster a risk management culture, providing quality assurance and facilitating the sharing of best practice.

Prudential's risk governance framework requires that all of the Group's businesses and functions establish processes for identifying, evaluating and managing the key risks faced by the Group. The framework is based on the concept of 'three lines of defence' comprising risk taking and management, risk control and oversight and independent assurance.

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The diagram above outlines the Group-level framework.

Primary responsibility for strategy, performance management and risk control lies with the Board, which has established the Risk Committee to assist in providing leadership, direction and oversight in respect of the Group's significant risks, and with the Group Chief Executive and the chief executives of each of the Group's business units.

Risk Management

Risk taking and the management thereof forms the first line of defence and is facilitated through both the Group Executive Committee ('GEC') and the Balance Sheet and Capital Management Committee ('BSCMC').

The GEC is comprised of the chief executives of each of the Group's major business units, as well as a number of functional specialists, and supports the Group Chief Executive in the executive management of the Group.

The BSCMC is comprised of functional specialists and supports the Chief Financial Officer in the management of the Group's balance sheet, as well as providing oversight to the activities of Prudential Capital, which undertakes the treasury function for the Group.

Risk Oversight

Risk control and oversight constitutes the second line of defence, and is achieved through the operation of a number of Group-level risk committees, chaired by either the Chief Financial Officer or

the Group Chief Risk Officer, which monitor and keep risk exposures under regular review . These committees are as follows:

Group Executive Risk Committee
The committee meets monthly to oversee the Group's risk exposures, including market, credit, liquidity, insurance and operational risks, and also monitors the Group's capital position.

Group Credit Risk Committee
The committee reports directly to the Group Executive Risk Committee and meets monthly to review the Group's investment and counterparty credit risk positions.

Group Operational Risk Committee
The committee meets quarterly to oversee the Group's operational risk exposures. The committee reports directly to the Group Executive Risk Committee.

Solvency II Technical Oversight Committee
The committee normally meets ten times per year to provide ongoing technical oversight and advice to the Board and executive in respect of their duties with regard to the Group's Internal Model. The committee reports to the Group Executive Risk Committee.

Technical Actuarial Committee
The committee reports to the Group Executive Risk Committee and usually meets monthly to set the methodology for valuing Prudential's assets, liabilities and capital requirements under Solvency II and the Group's internal economic capital basis.

Group Compliance Committee
The committee reports to the Group Executive Risk Committee and meets every two months to oversee the effectiveness of risk and capital management for all financial and non-financial risks faced by Prudential Group and has responsibility to consider Group-wide regulatory compliance risks and controls.

The Group-level risk committees are supported by the Group Chief Risk Officer, with functional oversight provided by Group Security, Group Compliance and Group Risk. Group Security is responsible for developing and delivering appropriate security measures with a view to protecting the Group's staff, physical assets and intellectual property. Group Compliance provides verification of compliance with regulatory standards and informs the Board, as well as the Group's management, on key regulatory issues affecting the Group. Group Risk has responsibility for establishing and embedding a capital management and risk oversight framework and culture consistent with Prudential's risk appetite that protects and enhances the Group's embedded and franchise value.

Independent assurance

The third line of defence comprises the Group wide Internal Audit function, which provides independent and objective assurance to the Board, GEC, Audit and Risk committees on the overall effectiveness of risk management, control and governance processes across the Group.

Reporting

The Risk Committee is provided with regular reports on the activities of the Risk function and, where it affects the results of the assurances under the Turnbull compliance statement, the Audit Committee also receives appropriate reporting from the same function. Reports to the Risk Committee include information on the activities of the Group Executive Risk Committee, the Group Operational Risk Committee, the Group Credit Risk Committee, the Solvency II Technical Oversight Committee, the Technical Actuarial Committee and the Group Compliance Committee, as well as reports from Group-wide Internal Audit.

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The Group's capital position and overall position against risk limits are reviewed regularly by the Group Executive Risk Committee, the Group Risk Committee and the Board. Key economic capital metrics, as well as risk-adjusted profitability information, are included in the business plans which are reviewed by the Group Executive Risk Committee, the Group Risk Committee and the Board.

Routine internal reporting by the business units vary according to the nature of the business, with each business unit responsible for ensuring that its risk reporting framework meets both the needs of the respective business unit and the standards set by the Group Risk function. Clear escalation criteria and processes are in place for the timely reporting of risks and incidents by business units to the various Group-level risk committees and, where appropriate, the Board.

Each business unit reviews the risks inherent in their business operations as part of the annual preparation of their business plan, and subsequently, these opportunities and risks are regularly reviewed against business objectives with Group Risk. The impact of large transactions or divergences from the agreed business plan are also reviewed and reported by Group Risk.

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Investments

General

The overall financial strength of Prudential 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 and Asia.

Prudential's Total Investments

The following table shows Prudential's insurance and non-insurance investments, net of derivative liabilities, at 31 December 2012. In addition, at 31 December 2012 Prudential had £121.4 billion of external funds under management. 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 A3 to the consolidated financial statements in Item 18.

	At 31 December 2012								
	UK Insurance	US Insurance	Asia Insurance	Total Insurance	Asset Management(a)	Other	Total	Less: assets to cover linked liabilities and external unit holders(b)	Group excluding assets to cover linked liabilities and external unit holders
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Investment properties	10,852	24	4	10,880			10,880	(1,095)	9,785
Investments accounted for using the equity method	72			72	41		113		113
Financial investments:									
Loans	3,373	6,235	1,014	10,622	1,199		11,821		11,821
Equity securities	36,027	49,551	14,310	99,888	70		99,958	(61,937)	38,021
Debt securities	83,862	32,993	21,402	138,257	1,846		140,103	(22,156)	117,947
Other investments	4,576	2,296	957	7,829	44	27	7,900	(58)	7,842
Deposits	11,131	211	1,227	12,569	84		12,653	(1,432)	11,221
Total financial investments	138,969	91,286	38,910	269,165	3,243	27	272,435	(85,583)	186,852
Total investments	149,893	91,310	38,914	280,117	3,284	27	283,428	(86,678)	196,750
Derivative liabilities	(1,007)	(645)	(837)	(2,489)	(150)	(190)	(2,829)	95	(2,734)
Total investments	148,886	90,665	38,077	277,628	3,134	(163)	280,599	(86,583)	194,016

(a)

Investments held by asset management operations are further split in note E2 to the consolidated financial statements in Item 18.

(b)

Prudential's Group statement of financial position includes the line by line investments of unit-linked and the consolidated unit-trusts and similar funds. In the table above, these amounts have been deducted in deriving the underlying investments in the right-hand column.

The disclosure below has been provided on the same basis as that included in previous Form 20-F submissions, with analysis focusing on the investments attributable to shareholders and consequently excluding those held to cover linked liabilities or attributable to unit holders of consolidated unit trusts and similar funds.

In addition to the detail provided below further analysis is included in the consolidated financial statements, in accordance with IFRS 7 'Financial Instruments: Disclosures'. The further analysis is included in notes D2, D3, D4, E2, G1 and G2 to Prudential's consolidated financial statements in Item 18.

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Prudential's Average Investment Return

The following table shows the income from the investments of Prudential's operations, net of derivative liabilities, by asset category for the periods indicated. This table does not include investment income from assets held to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds. Average investment return has been calculated using the average of opening and closing balances for the appropriate asset.

	Year Ended 31 December					
	2012		2011		2010	
	Average investment return	Amount	Average investment return	Amount	Average investment return	Amount
		£m		£m		£m
Investment properties						
Net investment income	**5.2%**	**512**	5.6%	557	5.6%	564
Net realised investment (losses) gains	**0.8%**	**81**	(1.0)%	(101)	0%	4
Net unrealised investment (losses) gains	**(0.6)%**	**(57)**	3.5%	354	5.2%	527
Ending assets		**9,785**		9,803		10,260
Investments accounted for using the equity method						
Net realised investment gains	**0.0%**		0%		78.5%	30
Ending assets		**113**		70		71
Loans						
Net investment income	**4.6%**	**500**	4.7%	442	5.2%	469
Net realised investment (losses) gains	**(0.3)%**	**(37)**	0%	1	(0.3)%	(26)
Net unrealised investment gains	**(0.6)%**	**(62)**	0.5%	46	(0.1)%	(10)
Ending assets		**11,821**		9,714		9,261
Equity securities						
Net investment income	**2.6%**	**841**	2.8%	995	2.6%	948
Net realised investment gains	**7.8%**	**2,570**	4.2%	1,505	4.2%	1,500
Net unrealised investment gains (losses)	**(0.3)%**	**(99)**	(11.0)%	(3,959)	6.6%	2,368
Ending assets		**38,021**		34,261		37,800
Debt securities						
Net investment income	**4.5%**	**5,213**	4.9%	5,168	5.1%	4,823
Net realised investment gains (losses)	**2.9%**	**3,396**	1.9%	2,038	1.5%	1,422
Net unrealised investment gains (losses)	**1.0%**	**1,189**	8.5%	2,776	2.3%	2,209
Ending assets		**117,947**		108,590		101,398

Other investments (including derivative liabilities)						
Net investment income	**10.9%**	**514**	9.7%	394	0.3%	13
Net realised investment (losses) gains	**(7.2)%**	**(340)**	0.6%	23	(11.0)%	(403)
Net unrealised investment (losses) gains	**13.1%**	**620**	8.5%	347	8.2%	299
Ending assets, net of derivative liabilities		**5,108**		4,444		3,693
Deposits						
Net investment income	**0.9%**	**90**	0.8%	78	0.5%	56
Ending assets		**11,221**		9,164		9,202
Total						
Net investment income	**4.1%**	**7,670**	4.4%	7,634	4.2%	6,874
Net realised investment gains (losses)	**3.1%**	**5,670**	2.0%	3,466	1.5%	2,526
Net unrealised investment gains (losses)	**0.9%**	**1,591**	(0.3)%	(436)	3.3%	5,394
Ending assets, net of derivative liabilities		**194,016**		176,046		171,685

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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.

Internal funds under management

Prudential manages 77 per cent of its group funds principally through its fund management businesses, M&G in the United Kingdom, PPM America in the United States and Eastspring Investments in Asia. The remaining 23 per cent of the Group's funds mainly relate to assets held to back unit-linked, unit trust and variable annuity liabilities.

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

Investments Relating to UK Insurance Business

Strategy

In the 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 maximise returns while maintaining investment quality and asset security and adhering to the appropriate government regulations.

Consistent with the product nature, in particular regarding guarantees, the with-profits fund's investment strategy emphasises 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 pension annuities business and other non-participating business the objective is to maximise profits while ensuring stability by closely matching the cash flows of assets and liabilities. To achieve this matching, the strategy is to invest in fixed income securities of appropriate maturity dates.

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

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Investments

The following table summarises the total investments, net of derivative liabilities, of the UK insurance business at 31 December 2012.

	At 31 December 2012					
	SAIF	PAC	Other	Total	Less: assets to cover linked liabilities and external unit holders Less:(a)	Total excluding assets to cover linked liabilities and external unit holders
	£m	£m	£m	£m	£m	£m
Investment properties	500	8,159	2,193	10,852	(1,096)	9,756
Investment accounted for using the equity method			72	72		72
Financial investments:						
Loans	116	1,993	1,264	3,373		3,373
Equity securities	2,070	19,875	14,082	36,027	(13,077)	22,950
Debt securities	3,864	46,643	33,355	83,862	(7,151)	76,711
Other investments	283	3,958	335	4,576	(11)	4,565
Deposits	910	8,395	1,826	11,131	(822)	10,309
Total financial investments	7,243	80,864	50,862	138,969	(21,061)	117,908
Total investments	7,743	89,023	53,127	149,893	(22,157)	127,736
Derivative liabilities	(36)	(652)	(319)	(1,007)	95	(912)
Total investment, net of derivative liabilities	7,707	88,371	52,808	148,886	(22,062)	126,824

(a) Please refer to the notes in the total Group investments table.

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The following table shows additional analysis of the investments relating to Prudential's UK insurance business, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, at 31 December 2012. The 'Other' column includes investments relating to solvency capital of unit-linked funds and investments relating to non-life long-term business.

	At 31 December 2012					
	With-Profits	PRIL	SAIF	Other	Total	Total
	£m	£m	£m	£m	£m	%
Investment properties	7,873	1,174	500	209	9,756	7.7
Investments accounted for using the equity method				72	72	0.1
Financial investments:						
Loans:						
Mortgage loans	1,289	150	22	1,108	2,569	
Policy loans	9		7		16	
Other loans	696	5	87		788	
Total loans and receivables	1,994	155	116	1,108	3,373	2.7
Equity securities:						
United Kingdom:						
Listed	9,363	2	1,066	82	10,513	
Unlisted	642		3	1	646	
Total United Kingdom	10,005	2	1,069	83	11,159	8.8
International:						
United States	1,073		97		1,170	
Europe (excluding the United Kingdom)	5,489		432		5,921	
Japan	1,035		116		1,151	
Pacific (excluding Japan)	1,592		173	6	1,771	
Other	1,594	1	183		1,778	
Total international	10,783	1	1,001	6	11,791	9.3
Total equity securities	20,788	3	2,070	89	22,950	18.1
Debt securities:						
UK government	2,182	2,141	120	604	5,047	
US government	966		187		1,153	
Other	42,653	21,597	3,557	2,704	70,511	
Total debt securities	45,801	23,738	3,864	3,308	76,711	60.5
Other investments:						
Other financial investments	3,004		214		3,218	
Derivative assets	953	324	69	1	1,347	
Total other investments	3,957	324	283	1	4,565	3.6
Deposits	8,395	669	910	335	10,309	8.0
Total investments	88,808	26,063	7,743	5,122	127,736	100.7

Derivative liabilities	**(619)**	**(256)**	**(36)**	**(1)**	**(912)**	**(0.7)**
Total investment, net of derivative liabilities	**88,189**	**25,807**	**7,707**	**5,121**	**126,824**	**100.0**

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Equity Securities

Prudential's UK insurance operations, had £22,950 million invested in equities at 31 December 2012 excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds. 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 in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At 31 December 2012 Market Value	
	£m	%
United Kingdom	11,159	48.6
United States	1,170	5.1
Europe (excluding United Kingdom)	5,921	25.8
Japan	1,151	5.0
Pacific (excluding Japan)	1,771	7.7
Other	1,778	7.8
Total	22,950	100.0

The UK equity holdings are well diversified. Prudential held equities in 378 UK companies at 31 December 2012. The ten largest holdings in UK equities at 31 December 2012 amounted to £3,569 million, accounting for 15.5 per cent of the total UK equity holdings of £22,950 million supporting the UK insurance operations. The following table shows the market value of the ten largest holdings in UK equities at 31 December 2012.

	At 31 December 2012	
	Market Value	Percentage of Total UK equities
	£m	%
BP	511	2.2
HSBC Holdings	441	1.9
British American Tobacco	431	1.9
Vodafone Group	425	1.9
GlaxoSmithKline	414	1.8
Royal Dutch Shell	353	1.5
Rio Tinto	351	1.5
Diageo	246	1.1
Unilever	203	0.9
Imperial Tobacco	194	0.8
Total	3,569	15.5

A wide variety of industry sectors are represented in Prudential's equity portfolio. At 31 December 2012, within the £11,159 million in UK equities supporting the UK insurance operations, Prudential had £9,802 million, or 87.8 per cent of the holdings, invested in ten industries. The following table shows

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the primary industry concentrations based on market value of the portfolio of UK equities relating to the UK insurance business at 31 December 2012.

	At 31 December 2012	
	Market Value	Percentage of Total UK equities
	£m	%
Banks	2,053	18.4
Oil & gas producers	1,694	15.2
Pharmaceuticals & biotechnology	1,197	10.7
Mining	1,032	9.2
Mobile telecommunications	726	6.5
Tobacco	662	5.9
Financial services	636	5.7
Travel & leisure	614	5.5
Support services	598	5.4
Media	590	5.3
Total	9,802	87.8

Debt Securities

At 31 December 2012, of the debt securities held by the UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, 91.9 per cent were issued by corporations and overseas governments other than the US, 6.6 per cent were issued or guaranteed by the UK government and 1.5 per cent were issued or guaranteed by the US government. These guarantees relate only to payment and, accordingly, do not provide protection against fluctuations in market price that may occur during the term of the fixed income securities.

The following table shows the market value of the debt securities portfolio by maturity at 31 December 2012, in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At 31 December 2012	
	Market Value	
	£m	%
Securities maturing:		
Within one year	1,112	1.4
Over one year and up to five years	10,226	13.3
Over five years and up to ten years	17,733	23.1
Over ten years and up to fifteen years	11,255	14.7
Over fifteen years	36,385	47.5
Total debt securities	76,711	100.0

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The following table shows debt securities by rating:

	At 31 December 2012 Market Value	
	£m	**%**
S&P AAA	**8,596**	**11.2**
S&P AA+ to AA-	**8,754**	**11.4**
S&P A+ to A-	**21,002**	**27.4**
S&P BBB+ to BBB-	**16,213**	**21.1**
S&P Other	**2,867**	**3.7**
	57,432	**74.8**
Moody's Aaa	**7,177**	**9.4**
Moody's Aa1 to Aa3	**1,288**	**1.7**
Moody's A1 to A3	**858**	**1.1**
Moody's Baa1 to Baa3	**1,167**	**1.5**
Moody's Other	**227**	**0.3**
	10,717	**14.0**
Fitch	**501**	**0.7**
Other	**8,061**	**10.5**
Total debt securities	**76,711**	**100.0**

* Further information is provided in note D2(c) to the consolidated financial statements in Item 18.

In the table above, Standard & Poor's (S&P) ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative. Where no external ratings are available, internal ratings produced by the Group's asset management operation, which are prepared on the Company's assessment of a comparable basis to external ratings, are used where possible. Further information is provided in note D2(c) to the consolidated financial statements in Item 18.

Real Estate

At 31 December 2012, Prudential's UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, had £9,756 million of investments in real estate. The following table shows the real estate portfolio by type of investment. The real estate investments are shown at market value in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At 31 December 2012 Market Value	
	£m	**%**
Office buildings	**3,530**	**36.2**
Shopping centers/commercial	**4,111**	**42.1**
Retail warehouses/industrial	**1,500**	**15.4**
Development	**465**	**4.8**
Other	**150**	**1.5**
Total	**9,756**	**100**

Approximately 44.9 per cent of the UK held real estate investment is located in London and Southeast England with 36.3 per cent located throughout the rest of the UK and the remaining 18.8 per cent located overseas.

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Investments Relating to Prudential's US Insurance Business

Strategy

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

The investment portfolio of the US insurance operations consists primarily of debt securities, although the portfolio also contains investments in mortgage loans, policy loans, common and preferred stocks, derivative instruments, cash and short-term investments and miscellaneous other investments.

Investments

The following table shows total investments, net of derivative liabilities, relating to the US insurance operations at 31 December 2012.

	31 December 2012		
	Variable annuity separate account assets	Fixed annuity, GIC and other business	Total
	£m	£m	£m
Investment properties		24	24
Financial investments:			
Loans		6,235	6,235
Equity securities	49,298	253	49,551
Debt securities		32,993	32,993
Other investments		2,296	2,296
Deposits		211	211
Total financial investments	49,298	41,988	91,286
Total investments	49,298	42,012	91,310
Derivative liabilities		(645)	(645)
Total investment, net of derivative liabilities	49,298	41,367	90,665

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The following table further analyses the investments, net of derivative liabilities of the US insurance operations, excluding the separate account investments supporting the variable annuity business, at 31 December 2012.

	31 December 2012	
	£m	%
Non-institutional		
Investment properties	24	0.1
Loans	5,941	14.4
Equity securities	196	0.5
Debt Securities		
Corporate securities	21,402	51.6
Government securities	4,113	10.0
Residential mortgage-backed securities	2,271	5.5
Commercial mortgage-backed securities	2,405	5.8
Other debt securities	497	1.2
Total debt securities	30,688	74.1
Other investments	2,092	5.1
Deposits	211	0.5
Derivative liabilities	(353)	(0.9)
Total non-institutional	38,799	93.8
Institutional		
Investment properties		
Loans	294	0.7
Equity securities	57	0.1
Debt Securities		
Corporate securities	1,839	4.5
Government securities	13	
Residential mortgage-backed securities	129	0.3
Commercial mortgage-backed securities	234	0.6
Other debt securities	90	0.2
Total debt securities	2,305	5.6
Other investments	204	0.5
Deposits		
Derivative liabilities	(292)	(0.7)
Total institutional	2,568	6.2
Total		
Investment properties	24	0.1
Loans	6,235	15.1
Equity securities	253	0.6
Debt Securities		
Corporate securities	23,241	56.1
Government securities	4,126	10.0
Residential mortgage-backed securities	2,400	5.8
Commercial mortgage-backed securities	2,639	6.4
Other debt securities	587	1.4
Total debt securities	32,993	79.7

Other investments	**2,296**	**5.6**
Deposits	**211**	**0.5**
Derivative liabilities	**(645)**	**(1.6)**
Total	**41,367**	**100.0**

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Under IFRS, for the insurance operations, debt securities are shown at fair value and loans are at amortised cost with the exception of certain policy loans which are held to back liabilities for funds withheld under reinsurance arrangements, which are also accounted on a fair value basis. Equity securities and investment properties are shown at fair value. The fair value of unlisted securities is estimated by Jackson using independent pricing services or analytically determined values.

Debt Securities

Corporate Securities

At 31 December 2012, the US insurance operations had £23,241 million of corporate securities representing 56.2 per cent of the US insurance operations total investments excluding separate account investments. Of the £23,241 million, £19,699 million consisted of debt securities that are publicly traded or trade under Rule 144A under the Securities Act of 1933, as amended ('Rule 144A') and £3,542 million consisted of investments in non-Rule 144A privately placed fixed income securities. Rule 144A is a 1990 SEC rule that facilitates the resale of privately placed securities that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

For statutory reporting in the US, debt securities are classified into six quality categories specified by the Securities Valuation Office of the National Association of Insurance Commissioners (NAIC). The categories range from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5. Securities in or near default are designated Class 6. Securities designated as Class 3, 4, 5 and 6 are non-investment grade securities. Generally, securities rated AAA to A by nationally recognised statistical ratings organisations are reflected in Class 1, BBB in Class 2, BB in Class 3 and B and below in Classes 4 to 6. If a designation is not currently available from the NAIC, Jackson's investment adviser, PPM America, provides the designation for the purposes of disclosure below.

The following table shows the quality of the publicly traded and SEC Rule 144A debt securities by NAIC classifications:

	2012 Carrying value		**2011 Carrying value**	
	£m	**% of total**	**£m**	**% of total**
NAIC designation:				
1	**7,575**	**39**	6,338	39
2	**11,096**	**56**	9,002	55
3	**681**	**3**	723	5
4	**315**	**2**	204	1
5	**27**		10	
6	**5**		4	
	19,699	**100**	16,281	100

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The following table shows the quality of the non-SEC Rule 144A private placement portfolio by NAIC classifications:

	2012 Carrying value		**2011 Carrying value**	
	£m	**% of total**	**£m**	**% of total**
NAIC designation:				
1	**1,392**	**39**	1,262	39
2	**2,067**	**59**	1,835	58
3	**66**	**2**	81	3
4	**3**		8	
5	**14**		12	
6				
	3,542	**100**	3,198	100

Residential Mortgage-Backed Securities

At 31 December 2012, the US insurance operations had £2,400 million of residential mortgage-backed securities, representing 5.8 per cent of US insurance operations total investments, excluding separate account investments. At 31 December 2012, of the £2,400 million, 2.4 per cent of this total were rated AAA. (Standard & Poor's ratings have been used where available and for securities where Standard & Poor's ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative).

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

Commercial Mortgage-Backed Securities

At 31 December 2012, the US insurance operations had £2,639 million of commercial mortgage-backed securities, representing 6.4 per cent of US insurance operations total investments, excluding separate account investments. 39.7 per cent of this total were rated AAA (Standard & Poor's ratings have been used where available and for securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative). Due to the structures of the underlying commercial mortgages, these securities do not present the same pre-payment or extension risk as residential mortgage-backed securities.

Other Debt Securities

At 31 December 2012, the US insurance operations had £2,296 million of other debt securities, representing 5.6 per cent of US insurance operations total investments, excluding separate account investments.

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Loans

At 31 December 2012, loans totalled £6,235 million, representing 15.1 per cent of US insurance operations total investments, excluding separate account investments. Of the total, £3,543 million related to commercial mortgage loans and £2,692 million to policy loans. Of the £2,692 million policy loans, £1,842 million were held to back the liabilities for funds withheld under reinsurance arrangements attaching to the purchase of REALIC in 2012 (as explained further in note I1 to the Prudential's consolidated financial statements in Item 18).

Commercial Mortgage Loans

At 31 December 2012, commercial mortgage loans represented 8.6 per cent of US insurance operations total investments excluding separate account investments. The average loan size is £6.4 million, collaterised by properties located in the United States.

Jackson has addressed the risk of these investments by building a portfolio that is diverse both in geographic distribution and property type.

The property types are mainly industrial, multi-family residential, suburban office, retail and hotel. The breakdown of the market value by property type is as follows:

	31 December 2012
	%
Industrial mortgage loans	**29.3**
Multi-family residential mortgage loans	**24.8**
Retail mortgage loans	**18.5**
Suburban office mortgage loans	**16.8**
Hotel mortgage loans	**10.2**
Other loans	**0.4**
Total	**100.0**

The following table shows the geographic split of the collateral for these loans:

	31 December 2012
	%
California	**12.9**
Florida	**9.1**
Georgia	**6.5**
Illinois	**6.7**
Texas	**9.7**
Other (sum of all states < 5% each)	**55.1**
Total	**100.0**

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

Policy Loans

Policy loans represented 6.5 per cent of US insurance operations total investments, excluding separate account investments at 31 December 2012. Policy loans are fully secured by individual life insurance policies or annuity policies and are contractual arrangements made under the policy. As described above, £1,842 million out of the £2,692 million policy loans were held to back the liabilities for funds withheld under reinsurance arrangements attaching to the purchase of REALIC in 2012.

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Equity Securities

Equity securities supporting US insurance operations, excluding separate account investments, totaled £253 million at 31 December 2012.

Other

Other financial investments of £2,296 million, representing 5.6 per cent of US insurance operations total investments, excluding separate account investments at 31 December 2012 were made up of £769 million of limited partnership interests and derivative assets of £1,546 million. See also note D3 to the Prudential's consolidated financial statements in Item 18 for further details on the use of derivatives by the US insurance operations.

The largest investment in the limited partnerships category is a £109 million interest in the PPM America Private Equity Fund. The remainder of this category consists of diversified investments in 166 other partnerships managed by independent money managers that generally invest in various equity and fixed income loans and securities.

Investments Relating to Asian Insurance Business

Prudential's Asian insurance operations' investments, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, largely support the business of Prudential's Singapore, Hong Kong, Malaysia, and Japan operations.

The following table shows Asia's investments, net of derivative liabilities, at 31 December 2012. In this table, investments are valued in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	31 December 2012						
	With-profits business	Unit-linked assets	Other	Total	Less: assets to cover linked liabilities and external unit holders(a)	Total excluding assets to cover linked liabilities and external unit holders	
	£m	£m	£m	£m	£m	£m	%
Investment properties			4	4		4	
Financial investments:							
Loans	600		414	1,014		1,014	4.4
Equity securities	3,160	10,491	659	14,310	(1,884)	12,426	54.5
Debt securities	11,495	3,194	6,713	21,402	(12,759)	8,643	37.9
Other investments	504	47	406	957	(47)	910	4.0
Deposits	165	574	488	1,227	(574)	653	2.9
Total financial investments	15,924	14,306	8,680	38,910	(15,264)	23,646	103.7
Total investments	15,924	14,306	8,684	38,914	(15,264)	23,650	103.7
Derivative liabilities	(446)		(392)	(838)		(838)	(3.7)
Total investment, net of derivative liabilities	15,478	14,306	8,292	38,076	(15,264)	22,812	100.0

(a)

Please refer to notes in the total Group investments table.

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

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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 Securities

The following table shows rating categorisation of the debt security investments of Prudential Corporation Asia's long-term insurance fund, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, at 31 December 2012.

	31 December 2012 Market Value	
	£m	%
S&P AAA	210	2.4
S&P AA+ to AA-	1,931	22.3
S&P A+ to A-	1,150	13.3
S&P BBB+ to BBB-	492	5.7
S&P Other	849	9.8
	4,632	53.6
Moody's Aaa	1,050	12.1
Moody's Aa1 to Aa3	126	1.5
Moody's A1 to A3	100	1.2
Moody's Baa1 to Baa3	81	0.9
Moody's Other	1	
	1,358	15.7
Fitch	440	5.1
Other*	2,213	25.6
Total debt securities	8,643	100.0

* Further information is provided in note D4(d) to the consolidated financial statements in item 18.

Equity Securities

The following table shows a geographic analysis of equity security investments of Asia's long-term insurance fund, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, at 31 December 2012.

	31 December 2012 Market Value	
	£m	%
Hong Kong	7,784	62.6
Singapore	3,829	30.8
Taiwan	381	3.1

Malaysia	**235**	**1.9**
Other	**197**	**1.6**
Total	**12,426**	**100.0**

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Description of Property   Corporate Property

As at 31 December 2012, Prudential's UK headquartered businesses occupied approximately 48 properties in the United Kingdom, Europe and India. These properties are primarily offices with some ancillary storage and warehouse facilities. Prudential's global headquarters are located in London. Of the remainder, the most significant are offices in London and Reading in England, Stirling in Scotland and Mumbai in India. The property in Stirling is held on a freehold basis, and is leased by the business from PAC's long-term fund. The rest of the properties occupied by Prudential's UK based businesses, in the UK and India, are held leasehold. In Europe, 15 of the properties are occupied leasehold and the rest (four) are short-term serviced offices. The leasehold properties range in size from 500 to 135,000 sq. ft. Overall, the UK, Europe and Mumbai occupied property portfolio totals approximately 780,000 sq. ft.

Prudential's UK headquartered businesses also hold one surplus owned property and approximately 46 surplus leasehold properties in the United Kingdom, spread geographically throughout the country. There are also three in Dublin, Ireland. This surplus accommodation (i.e. not occupied by the Group) totals approximately 365,000 sq. ft. There is also one surplus land holding in the United Kingdom, of 43 acres. A high proportion of the surplus estate has been sublet to third party occupiers generating income for the Group to cover this overhead. As at 31 December 2012 vacancy within the surplus estate stood at 59,000 sq ft.

In the United States, Prudential owns Jackson National Life's executive and principal administrative office located in Michigan. Prudential owns a total of seven facilities in Lansing, Michigan, which total 595,272 sq. ft. Prudential also leases premises in Michigan, Colorado, Tennessee, California, Illinois, New York, New Jersey, Georgia, Florida, Wisconsin, Massachusetts, Connecticut, New Hampshire, Pennsylvania, Indiana and North Dakota for certain of its operations. Prudential holds 29 operating leases with respect to office space, throughout the United States. The leasehold properties range in size from 500 180,000 sq. ft. In the United States, Prudential owns and leases a total of approximately 1,141,708 sq. ft. of property. In addition to the owned and leased properties, Prudential also owns a total of 238 acres of surplus land. This property is all located in Lansing, Michigan.

In Asia, Prudential owns or leases properties principally in Hong Kong, Singapore, Malaysia, Indonesia, Thailand, Philippines, China (JV), Taiwan, Japan, Vietnam, India (JV), Korea, United Arab Emirates and Cambodia.

Within these countries, Prudential owns 20 property assets, ranging from office space to land holdings. The break down of these owned assets by country is as follows:

Malaysia: six owned assets All office space totaling 12,315 sq. ft.

Philippines: two owned assets All office space totaling 4,278 sq. ft.

Singapore: one owned asset Office space totaling 11,883 sq. ft.

Thailand: eleven owned assets All surplus land holdings totaling 73,832 sq. ft.

Prudential has (excluding India), a total of 439 operating leases, (external and intercompany leases), totaling approximately 4.28 million square feet of property.

In India, Prudential holds a minority stake (26%) with ICICI in a joint venture which holds the property interests. The property is occupied by the ICICIPru Life and ICICIPru AMC businesses. The holding comprises approximately 700 leased properties, totaling approximately 1.3 million sq. ft. There is one owned and occupied asset comprising approximately 30,000 sq. ft. in Mumbai.

Prudential Corporation Asia's real estate strategy moving forward involves consolidation of its existing property portfolio to support its local business strategies throughout the region, to take advantage of opportunities in the regional markets in securing long term cost savings for the business while maintaining competitive advantage.

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There have been no property transactions subsequent to 31 December 2012 which would have a material impact on the financial position of Prudential.

Prudential believes that its facilities are suitable for the conduct of its businesses. We periodically review our space requirements and may acquire or lease new space as needed to accommodate any future needs of our businesses. Prudential's operating leases have no material commercial value.

In summary, Prudential owns 17 properties which it also occupies and which are accounted for as owner occupied. These properties are comprised of 9 in Asia, one in the UK and seven in the US. ICICIPru also owns and occupies one property in India. The total value of Prudential's owner occupied properties at 31 December 2012 was £216 million. This represents less than 0.1 per cent of Prudential's total assets.

Prudential is the lessee under 509 operating leases used as office accommodation, comprising 439 leases held by the Asian business, 29 leases held by the US business and 41 leases held by the UK businesses. For the UK based businesses, Prudential holds four short-term serviced offices.

Investment Interests

Prudential also holds interests in properties within its investment portfolios accounted for as investment property. At 31 December 2012 the total value of investment properties was £10,880 million and comprised 484 properties held by the UK, 3 held by the US and 21 held by the Asia business. In total they comprised 3.5 per cent of Prudential's total assets. The UK business' holdings account for over 99 per cent by value of the total investment properties.

Competition

General

There are other significant participants in each of the financial services 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 blurred traditional financial service industry lines and opened the market to new competitors and increased competition. In some of the 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/contract enhancement and bonus interest levels.

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

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Prudential offers different products in its different markets in Asia, the United Kingdom and the United States 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.

Asia

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

The global life insurers that are Prudential's competitors in the Asia Pacific region include AIA, Allianz, Aviva, AXA, ING and Manulife. Other competitors relevant in some of Prudential's key markets include HSBC Life in Hong Kong, Hanwha Life (formerly Korea Life), Kyobo Life and Samsung Life in Korea, Thai Life in Thailand, Great Eastern in Singapore and Malaysia, and China Life, China Pacific and Ping An in China. Prudential's principal competitors in respect of its fund management operations across the region largely comprise multinational asset managers including Fidelity Fund Management, Deutsche Asset Management, Blackrock, UBS Global Asset Management, JP Morgan Asset Management and BNP Paribas IP.

United States

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

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

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

United Kingdom

Prudential's principal competitors include many of the major retail financial services and fund management companies operating in the United Kingdom. These companies include Aviva, Legal & General, Standard Life, Friends Life, Lloyds Banking Group, Aegon, AXA, Just Retirement, Zurich Financial Services, Fidelity, Invesco Perpetual, Jupiter, Threadneedle, Schroders and BlackRock. Prudential

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competes with other providers of financial products to be included on financial advisors' panels of preferred providers.

Intellectual Property

Prudential conducts business under the 'Prudential', 'Jackson', 'M&G' and 'Eastspring Investments' brand names and logos. It is also the registered owner of over 100 domain names, including 'www.prudential.co.uk', 'www.prudentialcorporation-asia.com','www.jackson.com','www.mandg.co.uk', 'www.eastspringinvestments.com' and 'www.pru.co.uk'.

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. Under these arrangements Prudential Financial Inc has the right to use the Prudential name in the Americas and certain parts of the Caribbean, Japan, Korea and Taiwan and Prudential has the right to use the name everywhere else in the world although third parties have rights to the name in certain countries.

Legal Proceedings

Prudential

Prudential and its subsidiaries are involved in various litigation matters. While an adverse ruling in any individual case may not in itself be material to Prudential, if applied across all similar cases, the potential liabilities may be more significant. 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.

Jackson

Jackson is involved as a defendant in class action and other litigation substantially similar to class action and other litigation pending against many life insurance companies including a modal premium case and allegation of misconduct in the sale and administration of insurance products. Jackson generally accrues a liability for legal contingencies with respect to pending litigation once management determines that the contingency is probable and estimable. Accordingly, at 28 March 2013 Jackson had recorded an accrual of £8 million for class action litigation (31 December 2012: £18 million). Management, based on developments to date, believes that the ultimate disposition of the litigation is not likely to have a material impact on Jackson's financial condition or results of operations.

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 Annuity Specs, Asia Asset Management Magazine, Asosiasi Asuransi Jiwa Indonesia, Association of British Insurers, Association of Vietnamese Insurers, Association of Unit Trusts and Investment Funds, Fitch, Hong Kong Federation of Insurers, Hong Kong Office of the Commissioner of Insurance, HSBC Global Research, Insurance Regulatory and Development Authority of India, Insurance Services Malaysia Berhad, Investment Management Association, Life Insurance Marketing and Research Association (LIMRA), Life Insurance Association of Malaysia, Life Insurance Association of Singapore, Life Insurance Association of Taiwan, Morningstar, Moody's, Neilsen Net Ratings, Propriety Research, Service Quality Management Group, SNL Financial, Standard & Poor's, Thai Life Assurance Association, The Asset Benchmark Research, The Advantage Group, Townsend and Schupp and UBS.

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SUPERVISION AND REGULATION OF PRUDENTIAL

Supervision and Regulation

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

Until 1 April 2013, the UK Financial Services Authority (the 'FSA'), as Prudential's 'lead supervisor' for the purposes of the EU's Insurance Groups Directive (the 'IGD'), played a principal role in assessing and ensuring the adequacy of Prudential's solvency and financial stability on a Group-wide basis. The FSA has now been replaced in this role by the Prudential Regulation Authority (the 'PRA') as part of reforms to the UK regulatory architecture and this role in supplementary Group-level supervision will also be enhanced under the new EU solvency framework, Solvency II. Both of these developments are discussed further below.

As well as co-ordinating EU-level local regulators in the context of the IGD, as both Prudential's parent company and a significant proportion of its global insurance operations are in the UK, the FSA also played an important co-ordinating role in regulatory initiatives at a global level. This role is less formal than within the EU and has depended principally on the various memoranda of understanding signed by the FSA with non-EU regulators, including in the US and Asia. In consequence, although the FSA's role as a lead supervisor has not restricted the role of individual local regulators or overridden the local insurance and other financial services regimes described in the following sections, the FSA's rules and its regulatory agenda have impacted (and it is expected that the PRA's rules and regulatory agenda will similarly impact) Prudential's operations globally.

Moreover, because the UK regulatory framework is considerably shaped and influenced by directives emanating from the EU, the significant Group-wide impact of such rules may, at times, result in legal and regulatory developments in the EU (including the evolving Solvency II framework discussed below) in turn having a significant impact on the business and operations of the Group as a whole.

In March 2013, Prudential plc and The Prudential Assurance Company Limited settled with the FSA over issues relating to Prudential's unsuccessful bid to acquire AIA, the Asian subsidiary of AIG, in early 2010. The companies agreed to pay fines totalling £30 million, in respect of a decision by the FSA that it and the UKLA should have been informed earlier about Prudential's contemplation of the potential transaction. The Group Chief Executive also agreed to be censured in respect of a decision by the FSA that it should have been informed earlier. Final Notices published on 27 March 2013 concerning these decisions accordingly represent the final resolution of the matter.

In a statement accompanying the Final Notices, the FSA stated that the investigation was into past events and did not concern the current conduct of the management of the Prudential Group. The FSA accepted that Prudential did consider their obligations in forming their assessment in respect of informing the regulator. Therefore, although the FSA considered that the circumstances of the breaches were serious, the FSA did not consider the breaches were reckless or intentional. Prudential has confirmed that the Group Chief Executive acted at all times in the interests of the Company and with the full knowledge and authority of the Board. Prudential works diligently to maintain close and positive relationships with its regulators, and the Group's relationship with its UK regulators continues to be good.

Global Regulatory Developments

Currently there are a number of regulatory developments globally which may impact the supervision of Prudential in the future, including the work of the Financial Stability Board (the 'FSB') (an international entity established to coordinate, develop and promote effective regulatory, supervisory and other financial sector policies in the interest of financial stability) on Globally Systemically Important

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Financial Institutions ('G-SIFIs') and the Common Framework for the Supervision of Internationally Active Insurance Groups ('ComFrame') being developed by the International Association of Insurance Supervisors ('IAIS').

As part of a global initiative to identify G-SIFIs, in May 2012, the IAIS published proposed assessment methodology for designating Globally Systemically Important Insurers (G-SIIs). For those groups that are designated by the FSB as G-SII then additional policy measures including enhanced supervision, introduction of recovery and resolution plans and higher loss absorbency requirements could be proposed. Further detail of the proposals is expected during 2013 and implementation is likely to be over a period of years. Furthermore, the FSA is considering the designation of Domestically Systemically Important Insurer (DSII) for those UK insurers that are significant in UK terms. It is not yet clear what the impact of this designation may be.

ComFrame is also being developed by the IAIS to provide common global requirements for supervision of insurance groups. The framework is designed to develop common principles for supervision and so may increase the focus of regulators in some jurisdictions. It is also possible that some prescriptive requirements, including group capital, could be proposed. Further clarity on ComFrame is expected during the second half of 2013.

UK Supervision and Regulation

The Financial Services and Markets Act 2000

Prudential's insurance and investment businesses in the UK are regulated under the Financial Services and Markets Act 2000 ('FSMA 2000'). In addition, those businesses are subject to various UK laws (for example, the Data Protection Act 1998 in relation to the processing of customer data and various Pension Acts) some of which require the relevant Prudential entity to be licensed or registered. There have been extensive amendments to the FSMA 2000 regime as a result of the Financial Services Act 2012 and the 'legal cutover' to a new regulatory regime on 1 April 2013, described below.

New regulatory regime

Until 1 April 2013, FSA was the single regulator for all authorised persons carrying on regulated activities in the financial services sector and was empowered to make rules and issue guidance in relation to a wide sphere of activity, encompassing the governance, conduct of business and the prudential supervision of firms. From 1 April 2013, the FSA itself ceased to exist and has been replaced by:

- The PRA, which oversees macro-prudential regulation of deposit-takers and insurers and some systemically important investment firms; and

- The Financial Conduct Authority ('FCA'), which has responsibility for conduct of business regulation for all authorised firms and the prudential regulation of firms not regulated by the PRA. The FCA has also inherited the majority of the FSA's market regulatory functions (excluding certain functions which sit with the Bank of England).

Transition to the new regulatory regime has principally involved the allocation of the FSA's functions and responsibilities between the PRA and FCA, although the PRA and FCA are also vested with some additional to those exercised previously by the FSA and their statutory objectives differ from those of the FSA.

The substantive content of the FSA's macro-prudential and conduct of business regulation prior to 1 April 2013, including that discussed below under 'Main features of regulation applicable to Prudential's insurance and investment business', has not been materially affected as a result of the legal cutover, although it is too early to predict whether or how the substantive content of such regulation (or its

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interpretation) might evolve differently under the altered statutory objectives and regulatory approaches of the PRA and the FCA.

The FSA's risk-based approach to regulation

The FSA employed a risk-based regulatory approach to supervision under the FSMA 2000 pursuant to which each regulated firm's risk was assessed by the FSA using a risk assessment methodology known as ARROW (Advanced Risk Response Operating Framework). This was a high-level review aimed at assessing the significance of a particular risk posing threats to the FSA's statutory objectives under the FSMA 2000.

Prudential was regarded by the FSA as a high impact firm in view of the nature and complexity of its business and, as such, has generally received ARROW assessments at least once in every two year regulatory period. Between ARROW visits, the FSA met regularly with members of senior management and persons holding controlled functions to understand developing strategy and challenges and the key issues arising, in particular any significant risks identified and how Prudential was mitigating these. This 'close and continuous' supervision was supported by focused (relating to a firm or group) and themed (relating to the industry or market as a whole) visits where appropriate. In advance of discussions, the FSA requested relevant mandatory management information at prescribed intervals, which helped to frame the agenda for these meetings.

The approach of the PRA and FCA

Close and regular contact between the PRA and FCA and senior management and those performing controlled functions is expected to continue to be a feature of the UK regulatory regime following 1 April 2013, but the ARROW process has not been adopted by either regulator. Both regulators will continue to focus on risk, but their approaches are informed by separate statutory objectives and will be pursued through distinct supervisory programmes.

The strategic objective of the FCA is to ensure that the relevant markets function well and its operational objectives are to secure an appropriate degree of protection for consumers, to protect and enhance the integrity of the UK financial system and to promote effective competition in the interests of consumers. To meet these objectives, the FCA's supervision model is based on three pillars: a 'Firm Systemic Framework' ('FSF'), involving preventative work through structured conduct assessment of firms; 'event-driven' work covering issues which occur outside a firm's assessment cycle; and thematic reviews focused on particular sectors of the market aimed at product issues which the FCA identifies as driving poor outcomes for consumers or endangering market integrity. The FSF will involve Prudential being subject to, amongst other initiatives, a business model and strategy analysis ('BMSA') to establish which assessment areas to prioritise over a two-year cycle.

The FCA divides the firms it supervises into one of four conduct classifications (C1-C4) based on a combination of a measure of a firm's potential impact on FCA objectives and the number of retail customers a firm has, with C1 being the highest risk. Prudential has been categorised as 'C2', the second highest risk category. Additionally, as a group also regulated by the PRA with subsidiaries that are prudentially regulated by the FCA, Prudential has been assigned one of four prudential classifications (P1-P4). Prudential's entities that the FCA prudentially regulates in the group have been categorised as 'P1' as they are considered prudentially critical.

The PRA's statutory obligation is to promote the safety and soundness of PRA-authorised persons but it also has an additional insurance-specific objective: to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders. The PRA intends to weight its supervision towards those issues and those insurers that, in its judgment, pose the greatest risk to these objectives, conducting its assessment work on a continuous cycle.

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Compared with the approach adopted by the FSA, both the PRA and FCA intend to adopt a more judgment-led approach to supervision and to be more forward-looking in those judgments, i.e. assessing firms not just against current risks, but also against those which could plausibly arise in the future. The PRA has indicated that, for significant firms such as Prudential, it will, for example, conduct detailed analysis of their business model including forming its own projection of an insurer's ability to generate returns and the associated risks. In line with a more interventionist approach, the PRA has indicated that, if it believes that mitigating measures alone cannot adequately reduce material risks to safety and soundness and policyholder protection, it will require the insurer to change its business model.

Overview of FSMA 2000 regulatory regime

Principles for Businesses

An authorised firm is subject to a range of ongoing regulatory requirements of the FCA and, for dual-regulated firms, the PRA, including meeting at all times specified threshold conditions, including possession of adequate resources for the carrying on of its business and being fit and proper. A key feature of the FSA regime was the existence of 11 'Principles for Businesses', by which all authorised firms were expected to abide. These covered key areas such as the firm's relationship with the FSA and the need to act with integrity as well as to treat customers fairly. The Principles for Businesses will continue to be a feature of both PRA and FCA supervision although only certain of the Principles of Businesses have been adopted by the PRA. All have been adopted by the FCA.

Main features of regulation applicable to the Prudential's insurance and investment businesses

Supervision of management of authorised firms

Historically, the FSA closely supervised the management of authorised firms through the 'approved persons' regime, under which any appointment of persons who perform a 'controlled function', including functions that enable the exercise of significant influence over an authorised firm, must be pre-approved by the regulator. The approved persons regime continues to be administered by the PRA and the FCA, although certain additional controlled functions have been added under the new regime.

Intervention and enforcement

The FCA and PRA have extensive powers to investigate and intervene in the affairs of an authorised firm as well as extensive enforcement powers.

Certain of these intervention and enforcement powers are additional to those previously exercised by the FSA. For example, the FCA has powers to make temporary product intervention rules, allowing it block an imminent product launch or to stop an existing product, and is also able to require firms to withdraw or amend misleading financial promotions with immediate effect. Both the FCA and the PRA can also impose requirements on UK-incorporated unregulated parent undertakings that exert influence over authorised persons. The latter power is of particular potential relevance to the Group given that it is headed by a UK-incorporated unregulated parent undertaking but it remains to be seen how this new power will be used.

Conduct of Business Rules

The Conduct of Business Rules regulate the day-to-day conduct of business standards to be observed by authorised persons in carrying on regulated activities.

The scope and range of obligations imposed on an authorised firm under the Conduct of Business Rules varies according to the scope of its business and the range of its clients. Generally, however, the obligations imposed on an authorised firm by the Conduct of Business Rules will include the need to categorise its clients according to their level of sophistication, provide them with information about the

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firm, meet certain standards of product disclosure, ensure that promotional materials which it produces are clear, fair and not misleading, assess suitability when advising on certain products, manage conflicts of interest, report appropriately to its clients and provide certain protections in relation to client assets. Additional details of relevance to the insurance and investment businesses are discussed below.

Consumer Protection, the Financial Ombudsman Service ('FOS') and the Financial Services Compensation Scheme ('FSCS')

The consumer protection agenda in the UK is now within the remit of the FCA. The FCA's focus is on product scrutiny, sales practices and firms' culture, including assessment of how remuneration structures affect consumer outcomes. In addition, the FCA has a specific remit to promote competition within the financial services industry.

Authorised firms must have appropriate complaints handling procedures and the principles of complaints handling are defined in the FCA Handbook. However, once these procedures have been exhausted, qualifying complainants may turn to the FOS. The Ombudsman is empowered to order firms to pay fair compensation for loss and damage and may order a firm to take such steps as the Ombudsman determines to be just and appropriate in order to remedy a complaint.

The FSCS is intended to compensate individuals and other groups of 'eligible claimants', including certain trustees for claims against an authorised firm where the authorised firm is unable or unlikely to be able to meet those claims (generally, when it is insolvent or has gone out of business).

During 2012, the FSA undertook a comprehensive review of the FSCS funding model and made changes designed to ensure faster and more efficient payments by the FSCS to claimants. Further changes to the FSCS's comprehensive model were the subject of an FSA consultation (CP 12/16) which closed at the end of October 2012.

Following 1 April 2013, both the PRA and the FCA have rule-making powers for the FSCS and the FSCS is now accountable to both regulators.

Regulation of insurance business

Most of Prudential's subsidiaries that carry on insurance business in the UK, including PAC, Prudential Annuities Limited, Prudential Retirement Income Limited, Prudential Pensions Limited and Prudential Holborn Life Limited have become 'dual-regulated' following 1 April 2013, meaning that they are regulated by the PRA for prudential purposes and by the FCA for conduct purposes. The exceptions are Prudential Distribution Limited, Prudential Financial Planning Limited and Scottish Amicable ISA Managers Limited, which are regulated by the FCA only due to their business model.

Conduct of business requirements for insurance business

Authorised firms which advise and sell to retail customers packaged products such as life insurance policies are subject to detailed conduct of business obligations relating to product disclosure, assessment of suitability, the range and scope of the advice which the firm provides, and fee and remuneration arrangements.

The FSA launched the Retail Distribution Review ('RDR') in 2006 with the specific aim of addressing shortcomings in the retail investment market. On 31 December 2012, new rules took effect which, *inter alia*:

- required changes in how firms offering advice to retail customers present and describe the adviser services that they offer, including limiting the extent to which advisers can hold themselves out as 'independent';

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- banned the payment of commission when a personal recommendation is made and required the adoption of 'adviser charging', whereby a firm must set and clearly disclose its tariff of charges and where these are to be facilitated by a product provider, the amount must not be determined by the provider and there must be clear distinction from any product charges;

- imposed higher qualification requirements as well as continuing professional development and professional standards on advisers; and

- introduced increased reporting requirements on firms in respect of their retail investment advisers.

The changes introduced by the RDR are having a broad-ranging impact on Prudential, including necessitating significant system changes, affecting decisions as to which products Prudential offers and the pricing of those products, as well as expanding UK regulatory reporting requirements. For further information on RDR, see 'UK Business Distribution' and Item 5, 'Operating and Financial Review and Prospects Introduction and Overview'.

Capital requirements for insurers

As noted above, in order to maintain authorised status under the FSMA 2000, firms must continue to satisfy certain threshold conditions, which, among other things, require firms to have adequate resources for the carrying on of their business. The rules which govern the prudential regulation of insurers are currently found in the General Prudential Sourcebook ('GENPRU'), Prudential Sourcebook for Insurers ('INSPRU') and the Interim Prudential Sourcebook for Insurers ('IPRU (INS)') in the PRA Handbook. Solvency II, described further below, is the European Commission's project to reform prudential regulation of European Union insurers.

The rules require an insurer to prepare and submit to the PRA its own assessment of its capital requirements, known as an individual capital assessment ('ICA'), based on the risks it faces. Where the PRA disagrees with a firm's capital requirement assessment, it will issue individual capital guidance ('ICG'), including at times as a requirement.

Insurance companies must maintain assets sufficient to meet the relevant capital requirement at all times in respect of both long-term insurance and general insurance business undertaken by the company. The calculation of such capital requirements is dependent on the type and amount of insurance business a company writes. Under the rules in GENPRU, an insurer must hold capital resources equal at least to the Minimum Capital Requirement (the 'MCR'). Insurers with with-profits liabilities of £500 million or more must hold capital equal to the higher of MCR and the Enhanced Capital Requirement (the 'ECR'). The ECR is intended to provide a more risk responsive and 'realistic' measure of a with-profits insurer's capital requirements, whereas the MCR is broadly speaking equivalent to the previously required minimum margin under the IPRU (INS) and satisfies the current minimum EU standards.

The ECR is determined as the higher of two separate measurements of the firm's financial resources requirements, reflecting capital as determined by reference to two bases for calculating liabilities (regulatory and realistic), which is referred to as the 'twin peaks' approach. The regulatory basis reflects strict contractual liabilities whereas the realistic basis includes more discretionary but expected benefits, including those required to treat customers fairly.

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

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The extent to which long-term fund assets may be used for purposes other than long-term business is restricted by the rules in INSPRU. Only the 'established surplus' the excess of assets over liabilities in the long-term fund, as determined by an actuarial investigation may be transferred so as to be available for other purposes. Restrictions also apply to the payment of dividends by the insurance company, as described below. The rules in INSPRU require, in addition to the capital requirements referred to above, the maintenance of sufficient assets in the separate long-term insurance fund to cover the actuarially determined value of the insurance liabilities.

The rules also require banks, building societies, insurers and investment firms to undertake reverse stress testing. Reverse stress testing requires firms to work backwards from an assumed point of business model failure, to identify the stress scenarios that could result in such adverse outcomes. Each firm must then consider whether the likelihood of these scenarios, taking into account likely management actions, is consistent with its risk appetite and, if not, must initiate actions to address any inconsistencies.

Actuarial functions

The PRA's rules require every insurance company that carries on long-term business to appoint one or more actuaries to perform the 'actuarial function' in respect of all classes of its long-term insurance business and, the 'with-profits actuary function' in respect of all classes of that with-profits business (if any).

The actuary performing the 'actuarial function' must prepare at least annually, a report for the company's directors quantifying the company's long-term liabilities attributable to the insurance company's long-term insurance business, determining the value of any excess over those liabilities of the assets representing the long-term insurance fund and, where any rights of long-term policyholders to participate in profits relate to particular parts of such a fund, a valuation of any excess of assets over liabilities in respect of each of those parts.

The actuary performing the 'with-profits actuary function' must, amongst other responsibilities, advise the firm's management on key aspects of the discretion to be exercised affecting these classes of the with-profits business of the firm, and, at least once a year report to the firm's governing body on key aspects (including those aspects of the firm's application of its Principles and Practices of Financial Management ('PPFM') on which the advice described above has been given) of the discretion exercised in respect of the period covered by his report. All firms that carry on with-profits business are required to publish the PPFM that are applied in the management of their with-profits funds.

Distribution of profits and with-profits business

Under IPRU (INS), 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 a defined 'relevant minimum' of the surplus has been allocated to policyholders or a statutory notification procedure has been followed.

There has been considerable public debate about the rights and legitimate expectations of with-profits policyholders to assets forming part of an insurance company's surplus. The FSA confirmed in July 2009 that proprietary life insurance companies will not be able to meet future compensation and redress payments from their with-profits funds, and the FSA confirmed a rule change, meaning that liabilities arising from operational failures (including mis-selling) after the rule came into effect from 31 July 2009 should be met by shareholder funds rather than policyholder funds.

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With-profits business

The with-profits business was an area of focus for the FSA, including specifically: the costs charged to a with-profits fund by the firm managing the fund; penalties and charges levied on policyholders who surrender their policies early; the need for funds to be managed with the objective of ensuring that maturity payouts fall within a target range set for the fund; and the provision of information to with-profits policyholders or potential policyholders in a format that they can more readily understand.

On 1 April 2012, the FSA introduced further changes to its rules and guidance in a number of areas relevant to the operation of with-profits funds, including in relation to: conflicts of interest with the potential to prejudice with-profits policyholders; the fair treatment of with-profits policyholders in mutually-owned funds; the terms on which new business may be written by with-profits insurers; communications and planning surrounding material reductions in new business; the application of market value reductions; the use of with-profits funds to make strategic investments; the removal of the ability of firms to reattribute excess surplus; rules surrounding reattribution of inherited estates; and changes to the rules surrounding corporate governance.

The PRA and FCA now share responsibility for protecting policyholders' reasonable expectations in relation to with-profits business. The PRA seeks to ensure that any discretionary benefit allocations or other changes with financial implications that the insurer has proposed are compatible with its continued safety and soundness, whereas the FCA has responsibility for monitoring whether the proposed changes are consistent with the insurer's previous communications, the FCA's conduct rules and the overriding obligation to treat customers fairly. The PRA has the power to prevent allocations being made if they would materially impair the firm's safety and soundness.

Gender discrimination in contracts of insurance

In a 2011 decision, the European Court of Justice ('the ECJ') ruled that gender-related factors could not be used in determining premiums and benefits under insurance policies. The ECJ granted a transitional period of relief for implementation until 21 December 2012 and the UK Government amended the Equality Act 2010 during 2012 to give effect to the judgment. Although the full effect of the ruling in the UK and other EU member states remains uncertain to date, the scale of the judgment is contributing to a period of uncertainty. In particular, it is unclear how insurance contracts that were entered into prior to the ruling but which have continued in force after 21 December 2012, will be treated. In practice, the requirement for unisex premiums has been seen to affect the cost of some types of insurance for both men and women, notably car insurance, life insurance, health insurance, and the cost of an annuity a financial product that provides a regular pension income.

Auto enrolment

From October 2012, auto enrolment into a workplace pension was introduced, opting in millions of workers to a workplace pension, with contributions from the employers and the government in most cases, as well as a percentage of pay automatically being taken. Individuals can choose to opt out, but the aim is to tackle reliance on the state pension in retirement.

EU Directives on groups

Prudential is subject to the capital adequacy requirements of the IGD, as implemented in the PRA rules. The IGD pertains to groups whose activities are primarily concentrated in the insurance sector.

Historically, the FSA, as lead supervisor of Prudential under the IGD, supervised Prudential on a group basis in addition to supervising the UK insurance companies within Prudential individually. This is referred to in the IGD as supplementary supervision and encompasses such matters as general supervision over intra-group transactions (including, *inter alia*, loans, guarantees and off-balance sheet

transactions, investments, reinsurance, retrocession and cost sharing agreements), group risk management processes and internal control mechanisms, and reporting and accounting procedures. In accordance with the IGD, the FSA required the calculation of group capital resources on a consolidated basis and required that such group capital resources are equal to or in excess of Prudential's group capital resources requirement (each as calculated in accordance with INSPRU).

The FSA also played a coordinating role amongst EU regulators under the IGD. Due to the geographically diverse nature of Prudential's operations, the application of these requirements to Prudential is complex. In particular, for the purposes of calculating the group capital requirement and actual group capital resources under INSPRU, for many of the Asian operations, the assets, liabilities and capital requirements have to be recalculated based on UK regulations as if the companies were directly subject to such regulation.

As noted above, the FSA has been replaced in its lead supervisory role by the PRA following the legal cutover on 1 April 2013.

New EU solvency framework

The European Commission is continuing to develop a new prudential framework for insurance companies, 'Solvency II', which will repeal and replace the existing Life, Non-life, Re-insurance and IGD directives. The main aim of this framework is to ensure the financial stability of the insurance industry and protect policyholders through solvency requirements better matched to the true risks of the business.

Solvency II adopts a three-pillar approach to prudential regulation, which is similar to the 'Basel II' approach that has already been adopted in the banking sector in Europe.

Although the Solvency II Directive has similarities to the current UK regime set out in GENPRU and INSPRU in terms of its risk-based approach to the calculation of capital requirements and use of capital tiering, there are also many differences both in terms of substance and terminology. For example, while both regimes share the principle of a market consistent valuation of assets and liabilities, there are differences in the detailed valuation methodologies.

A key aspect of Solvency II is the focus on a supervisory review at the level of the individual legal entity. Insurers will be encouraged to improve their risk management processes and will be allowed to make use of internal economic capital models to calculate capital requirements, subject to approval by the PRA. In addition, Solvency II requires firms to develop and embed an effective risk management system as a fundamental part of running the firm.

The new regime will require firms to disclose a considerably greater level of qualitative and quantitative information than under current rules, both to their own supervisor through Regular Supervisory Reporting ('RSR') and to the market through the publication of a Solvency and Financial Condition Report ('SFCR'). This is intended to increase transparency, allowing easier comparison across the industry and enabling supervisors to identify sooner if firms are heading for financial difficulty. In turn, increased transparency is intended to drive market discipline, arising from the reaction of ratings agencies and the capital markets to firms' performance.

Further details on Solvency II and its implication for the Group are set out in Item 4 Group Risk Framework. As described in that section, the previously anticipated implementation date for Solvency II of 1 January 2014 is now expected to be delayed. At this stage, it remains unclear exactly when Solvency II will come into force, although a deferral until 1 January 2016 or beyond appears likely.

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ICAS+

It is now widely acknowledged that full implementation of Solvency II by 1 January 2014 is unrealistic. Regulators across Europe are now considering how they can ensure that the momentum built towards better risk management gained over the last few years is not lost. Insurers are also keen to leverage improved governance, risk management, and capital models developed as part of Solvency II implementation rather than see this effort being wasted or sidelined.

The FSA has already confirmed that within the UK the existing ICAS regime will continue to operate and it is anticipated this will have a renewed focus from the PRA. Many companies (in particular those in the Internal Model approval process) are planning to review their ICA in 2013 both to ensure it remains fit for purpose and to investigate areas where they can incorporate elements of their Solvency II developments.

In October 2012, the FSA announced its initial thoughts on how Internal Model companies could transition from the ICAS regime to Solvency II. It confirmed its thinking in a letter to companies on 29 January 2013. The FSA proposed to allow companies to use the Solvency II Internal Model (or elements of it), subject to it being of an appropriate standard, to calculate their ICAS under what is being called 'ICAS+'. In addition, it is likely that companies will need to submit an in-development ORSA as part of their ICAS+ submission. More detail is expected in the second quarter of this year.

Regulation of investment business

Certain of Prudential's subsidiaries were authorised by the FSA to carry on investment business. These entities were subject to regulation and supervision by the FSA and had to comply with the FSA Conduct of Business and Prudential Rules made under the FSMA 2000. After 1 April 2013, these subsidiaries have been regulated by the PRA and FCA. Not all subsidiaries are dual regulated, some are regulated by the FCA only for both conduct and prudential matters, such as the M&G subsidiaries.

One of the Prudential's UK subsidiaries, M&G Investment Management Limited, is also regulated by the United States' Securities and Exchange Commission (the "SEC") so that it can act as investment adviser to a number of US mutual funds.

Conduct of business requirements for investment businesses and the Markets in Financial Instruments Directive ('MiFID')

MiFID sets out detailed and specific organisational and conduct of business requirements for investment firms and regulated markets. In October 2011, the European Commission published proposals to amend MiFID and introduce a new Markets in Financial Instruments Regulation ('MiFID 2'). Among other things, the proposals were designed to expand the scope of MiFID, both in terms of the types of firms and instruments (e.g. structured deposits and emissions allowances) its requirements encompass. The impact on our M&G investment management business will be mainly around fixed income and derivatives.

MiFID 2 is still being negotiated through the European legislative process and areas of uncertainty remain. The pre-trade transparency would also apply to a wider range of instruments: bonds and derivatives in addition to shares. If the threshold is set at too low a level, asset managers like M&G could potentially have to publish quotes received within three minutes. It is also possible that MiFID 2 could impose a partial or full ban on inducements to advisers, similar to that introduced by the RDR in the UK (as described above). This could require M&G to modify its European adviser charging model. MiFID 2 is expected to be agreed during 2013 at the earliest, with its changes taking effect in 2014 or 2015.

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Capital requirements for investment businesses

The capital requirements for investment businesses are contained in the Prudential Standards section of the PRA Handbook. These rules implement the requirements of the EU's Recast Capital Adequacy Directive (Directive 2006/49/EC), which together with the EU's Banking Consolidation Directive (Directive 2006/49/EC) constitute the Capital Requirements Directive ('CRD'). CRD has been amended a number of times and the European Commission has proposed a legislative package known as 'CRD IV' which will replace CRD in order, amongst other ends, to implement the rules proposed by the Basel Committee on Banking Supervision, known as 'Basel III'. This is likely to slightly increase the capital requirements for M&G. CRD IV is currently expected to be finalised in 2013, although this may be delayed.

Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD, a Directive designed to regulate the managers, management and marketing of alternative investment funds including private equity and hedge funds entered into force on 21 July 2011. EU Member States must implement it by 22 July 2013, and a key element in implementing the Directive will be the adoption of a European Commission regulation ('the Level 2 Regulation') specifying much of the detail with which affected firms will have to comply. The FSA published the first part of its consultation on the implementation of the AIFMD in November 2012 and the second consultation in the first quarter of 2013. HM Treasury also published a consultation paper in January 2013 covering the Government's proposed approach to a number of key policy decisions in relation to the transposition of the Directive into UK law and is to issue a second paper in due course. M&G is running a comprehensive project to ensure that all of its alternative investment fund managers meet the requirements of the AIFMD, which are similar to the existing requirements for retail mutual fund managers.

European Market Infrastructure Regulation ('EMIR')

The Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties (CCPs) and trade repositories, widely known as European Market Infrastructure Regulation, or 'EMIR', came into force on 16 August 2012. Its key provisions, however, are taking effect on a phased basis from the beginning of 2013 following the provision of guidance and standards on the implementation of EMIR by European Securities and Markets Authority ('ESMA') and the European Commission. EMIR's rules are intended to lessen risk and increase transparency within the OTC derivative markets by introducing for most counterparties: (i) a reporting obligation for OTC derivatives; (ii) a clearing obligation for eligible OTC derivatives; (iii) measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives, including through collateral requirements; (iv) common rules for CCPs and for trade repositories; and (v) rules on the establishment of interoperability between CCPs. M&G is running a comprehensive project to implement necessary changes, by the relevant deadlines.

Asian Supervision and Regulation

1. Regulation of insurance business

Prudential's businesses in Asia are subject to all relevant local regulatory and supervisory schemes. These laws and regulations vary from country to country, but the regulators typically grant (or revoke) licenses and therefore control the ability to operate a business.

Industry regulations are usually widely drawn and include provisions governing both financial matters and the way business is conducted in general. In general, regulatory regimes will include features governing the registration of agents, the approval of products, asset allocation, minimum capital and the basis for calculating the company's solvency and reserves and the valuation of policyholder

liabilities, conditions for outsourcing non-core functions, policyholder and investor protection and regulation of product features, as well as anti-money laundering and 'know your client' requirements and data protection requirements. Regulatory authorities may also regulate affiliations with other financial institutions, shareholder structures and the injection of capital and payment of dividends. Financial statements and other returns are filed with the regulators. The regulators may also conduct physical inspections of the operations from time to time. A number of jurisdictions across Asia require insurance companies to participate in policyholder protection schemes (ie contribute to a fund to support policyholders in the event of an insurance company failing).

Regulatory standards are generally being raised, and insurance companies operating in Asia are finding themselves subject to increasing regulatory supervision and scrutiny. In general, the pace of regulatory developments has increased since 2008 in most markets, particularly in relation to risk capital, consumer protection and governance requirements. For example, greater regulatory emphasis is being placed on ensuring that products are fit for purpose and that customers fully appreciate the features of their policies, as well as on data privacy. Also whereas the need for compliance with relevant regulations was always implicit in the way insurers ran their businesses, there is a trend towards a more explicit demonstration of this through documentation, audits and more formal management structures. This increased regulatory pressure will continue as Asian regulators begin to take on board the new International Association of Insurance Supervisors (IAIS) standards, which is expected to translate into an accelerating trend around a sharper focus on risk management systems and a requirement to hold more capital to manage asset and liability positions.

The increasingly extraterritorial approach of certain regulators outside Asia, aimed among other things at protecting financial systems from systemic risks and curbing tax avoidance, could have wider consquences on financial groups in the Asia-Pacific region. For example, firms based outside the US are increasingly being required to comply with certain US originated rules like FATCA (see 'US Supervision and Regulation Implementation of US Foreign Account Tax Compliance Act ('FATCA') provisions' below), which will impact on the bancassurance business channel as banks will have to set up separate systems to deal with US customers. The effects of UK anti-bribery legislation have become increasingly significant outside the UK, and Prudential Corporation Asia's ('PCA's') business units will be required to adhere to Prudential's group-wide policy designed to comply with the EU Solvency II requirements (although they will not each be required to be compliant on a solo entity basis). Asian regulators are monitoring closely how Solvency II is developed and implemented but are not currently requiring regulated insurance entities to comply.

Certain additional details of the regulatory regimes to which PCA's insurance operations are subject are discussed below:

Hong Kong The Prudential Assurance Company Limited

Overview

The Hong Kong branch of The Prudential Assurance Company Limited is authorised to carry on both long-term business and general business in Hong Kong under a composite license. By virtue of its branch status, the lead regulator on capital requirements of the Hong Kong business is the UK PRA. Further details on the PRA approach to capital requirements are explained in the UK Supervision and Regulation section above.

The Office of the Commissioner of Insurance (the 'OCI') is currently the regulatory body that administers the Insurance Companies Ordinance (the 'ICO'). The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority (the 'IA') for administering the ICO. The principal functions of the IA are to ensure that the interests of policyholders or potential policyholders are protected and to promote the general stability of the insurance industry, including by authorising insurers to carry on insurance business in Hong Kong, regulating insurers' conduct primarily

through the examination of the annual audited financial statements and business returns insurers submit, and development of legislation and guidelines on insurance supervision. A key supervisory responsibility relates to solvency margin requirements contemplated by the ICO, as further discussed below.

The Financial Services and Treasury Bureau has issued a public consultation on its proposed plans for an Independent Insurance Regulator (IIR) in Hong Kong. Legislation is expected in 2013, with the IIR on track to be established in 2015.

The branch is also subject to the codes and guidance developed by a self-regulatory body the Hong Kong Federation of Insurers (the 'HKFI'). HKFI actively promotes its self-regulatory regime with respect to areas like conduct of insurers and insurance intermediaries, cooling off initiatives, policy replacement and initiative on needs analysis, etc. The Insurance Agents Registration Board of the HKFI is responsible for administering the registration and approval of insurance intermediaries of insurance agents, their responsible officers and technical representatives; and handling complaints against them and providing enquiry services to and handling complaints from the public relating to insurance agents.

In addition, the sale of mandatory pension products by agents is regulated by the Mandatory Provident Fund Authority (the 'MPFA'), which licenses and supervises the conduct of MPF intermediaries and the supervision of the conduct of MPF intermediaries.

The branch is also regulated by the Hong Kong Securities and Futures Commission (the 'SFC') for its offering of Investment Linked products.

Capital requirements

Under the ICO, an insurer is required to maintain at all times an excess of assets over liabilities of not less than a required solvency margin. The objective is to provide a reasonable safeguard against the risk that the insurer's assets may be inadequate to meet its liabilities arising from unpredictable events, such as adverse fluctuations in its operating results or the value of its assets and liabilities.

For general business insurers, the ICO stipulates an absolute minimum solvency margin of HK$10 million, or HK$20 million in the case of a composite insurer (i.e. carrying on both general and long term business) or for an insurer wishing to carry on statutory classes of insurance business. Above these minimum levels, solvency margins are calculated on the basis of the greater of an insurer's relevant premium income (defined as the greater of gross premium income after deduction of reinsurance premium payments or 50 per cent of gross premium income) or relevant outstanding claims (defined as the sum of unexpired risks plus the greater of 50 per cent of claims outstanding before deduction of sums recoverable from reinsurers or the amount of claims outstanding after deduction of sums recoverable from reinsurers).

For long-term business insurers, the ICO stipulates an absolute minimum solvency margin of HK$2 million. Above this minimum level, solvency margins are determined in accordance with the Insurance Companies (Margin of Solvency) Regulation (Chapter 41 F of the Laws of Hong Kong), which sets out a series of calculations to be used depending on the particular class of long-term business involved.

For composite insurers, the ICO stipulates a minimum solvency margin based on the aggregate of the solvency margin required in respect of an insurer's general business and its long-term business, both calculated as described above.

Taiwan PCA Life Assurance Company Limited

Overview

PCA Life Assurance Company Limited is licensed to conduct life insurance business in Taiwan.

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The Financial Supervisory Commission ('FSC') is responsible for regulating the entire financial services industry, including the banking, securities and insurance sectors. The FSC's responsibilities include supervision, examination and investigation. The Insurance Bureau ('IB') under the FSC is responsible for the insurance sector. The Financial Examination Bureau (the 'FEB') under the FSC acts as the executive supervisory authority for the FSC and principally carries out examinations and on-site visits of insurance companies, generally every two years. The Investigation Bureau under the Ministry of Justice is responsible for supervision of anti-money laundering and counter-terrorism financing efforts.

Capital Requirements

The Insurance Act requires all insurance companies to maintain a risk-based capital (RBC) ratio of not less than 200 per cent. The ratio is determined as the adjusted net capital compared against the risk-based capital. This measurement takes into consideration asset, insurance, interest and other relevant risks as requires in calculating the capital on a risk adjusted basis. Any company failing the threshold may be subjected to measures ranging from restrictions in business operations to the withdrawal of business license.

Korea PCA Life Insurance Company Limited

Overview

PCA Life Insurance Company Limited is authorised to carry on life insurance business in Korea including but not limited to casualty insurance, illness insurance, nursing insurance and incidental business and services related thereto.

Korea's financial supervision structure is composed of the Financial Services Commission (the 'FSC') and the Financial Supervisory Service (the 'FSS'). As Korea's principal supervisory authority, the FSC is given a broad statutory mandate to carry out three key functions: financial policy formulation, financial institution and market oversight, and anti-money laundering. It also issues regulatory licenses to financial institutions. The Financial Supervisory Service (the 'FSS') acts as the executive supervisory authority for the FSC and principally carries out examination of financial institutions along with enforcement and other oversight activities as directed or charged by the FSC.

In respect of anti-money laundering, the Korea Financial Intelligence Unit ('KoFIU'), a part of the FSC leads the government's anti-money laundering and counter terrorism financing efforts.

Korean laws permit an insurer to operate only one license (life or non-life) at any one time. In the past, the FSC has been highly interventionist in setting and enforcing rules on the insurance industry. In recent years the FSC has moved away from its interventionist approach, in response to the evolving and liberalised landscape. The most prominent change has been a deregulation in asset management and product design activities. However, in connection with deregulation, the FSC has also sought to strengthen supervision. Additions and amendments to Korean law and regulation aimed at protecting consumers have, amongst other things, resulted in expansion of the scope of concurrent/ancillary businesses which can be conducted by insurance companies, new reporting requirements for foreign insurers' Korean offices, new regulations governing asset management by insurance companies, and updated processes for development of insurance products, prohibitions on corporate insurance agents and corporate insurance brokers from engaging in other business, new additions to the list of acts prohibited when entering into insurance contracts or soliciting consumers and additional and more specific requirements in respect of data protection.

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Capital requirements

A risk-based supervision framework applies to insurers, encompassing the risk-based capital solvency requirement, the risk assessment and application system (RAAS), which assesses insurers' various risks and relevant internal controls, and risk disclosure.

Under RBC solvency, the ratio of an insurer's available capital to required capital is calculated, and the analysis of equity capital used to determine capital adequacy must take into account market, credit, operational, insurance and interest rate risks, which are not taken into consideration under the solvency margin requirement.

In the event an insurer fails to satisfy the applicable capital adequacy requirement and this poses a threat to the financial soundness of that insurer in Korea, the FSC may take corrective action, ranging from issuing a recommendation to an insurer to increase its capital reserves or to restrict its investments in high-risk securities and other assets to issuing an order to an insurer to suspend its business or transfer it to a third party.

Singapore Prudential Assurance Company Singapore (Pte.) Limited

Overview

Prudential Assurance Company Singapore (Pte.) Limited is registered by the Monetary Authority of Singapore (the 'MAS') to design and sell both life and general insurance business pursuant to the Singapore Insurance Act.

Under the Singapore Insurance Act, the MAS is responsible for insurance regulation and supervision of insurance companies. MAS regulation covers, among other things, the appointment and training of representatives, maximum tier structure, loans and advances, disciplinary action, product disclosure, sales processes and replacement (switching) of life policies. The MAS also has responsibility for supervising compliance with anti-money laundering ('AML') provisions, though suspicious transactions must be notified to the Commercial Affairs Department, an enforcement agency of the Singapore Police Force.

Another relevant regulatory authority for the business is the Central Provident Fund (the 'CPF') Board, which acts as a trustee of social security savings schemes jointly supported by employees, employers and the government. The CPF Board regulates insurers in the operation of various CPF schemes including the CPF Investment Scheme where CPF monies are used by policyholders to purchase insurance policies such as annuities and investment linked policies.

The MAS and CPF Board have very detailed regulatory frameworks to govern insurance companies and the distribution of insurance products in Singapore.

Capital requirements

Registered insurers in Singapore are subject to a risk based capital ('RBC') framework. The framework sets out the valuation methodology for assets and liabilities, rules relating to the operations of life insurance funds, capital requirement rules, the role of actuaries, and a set of statutory reporting standards. An insurer has to notify the MAS when it has failed or is likely to fail to comply with the mandated RBC indicators or when a financial resources warning event has occurred or is likely to occur.

A registered insurer is required at all times to maintain a minimum level of paid-up ordinary share capital and to ensure that its financial resources are not less than the greater of the sum of the aggregate of the total risk requirement of all insurance funds established and maintained by the insurer under the Singapore Insurance Act; and where the insurer is incorporated in Singapore, the total risk requirement arising from the assets and liabilities of the insurer that do not belong to any insurance fund established and maintained under the Singapore Insurance Act (including assets and liabilities of

any of the insurer's branches located outside Singapore); or a minimum amount of 5 million Singapore Dollars.

The MAS also has the authority to direct that the insurer satisfy capital adequacy requirements other than those that the insurer is required to maintain under the Singapore Insurance Act if the MAS considers it appropriate.

Malaysia Prudential Assurance Malaysia Berhad

Overview

Prudential Assurance Malaysia Berhad has composite licenses to carry on both life and general insurance business in Malaysia pursuant to the Insurance Act 1996.

In Malaysia, Bank Negara Malaysia ('BNM') is the regulatory body responsible for supervising and regulating the conduct of insurance business. BNM places considerable emphasis on fair market conduct by the insurance industry and protection of consumers' interests.

In addition, the company is a member of the Life Insurance Association of Malaysia and the General Insurance Association of Malaysia, which are both self-regulated bodies. Resolutions and circulars issued by these associations are binding on the member insurance companies.

Capital requirements

BNM has introduced an RBC framework aimed at improving the risk management practices of insurers. Under the RBC framework, insurers are required to maintain a capital adequacy level that is commensurate with their risk profiles. Each insurer is required to determine the adequacy of the capital available in its insurance and shareholders' fund to support the total capital it requires. This serves as a key indicator of the insurer's financial resilience and is used by BNM to determine the need for supervisory interventions.

Under the RBC framework guidelines, the Board of Directors and senior management of an insurer are also expected to identify, monitor and control risks which are not adequately addressed under the framework. An insurer is also expected to manage actively its capital adequacy by taking into account the potential impact of its business strategies on its risk profile and overall financial resilience.

BNM implemented the internal capital adequacy assessment process (ICAAP) regime for the insurance sector in September 2012. This set out the framework for meeting risk-based capital requirements. The ICAAP is a comprehensive and forward looking assessment which requires insurance companies to consider material risks to demonstrate how they will be linked to their capital management program.

Malaysia (Takaful business) Prudential BSN Takaful Berhad

Overview

Prudential BSN Takaful Berhad ('Prudential Takaful') (a Prudential joint venture with Bank Simpanan Nasional) was the first overseas insurer to be granted a domestic Takaful License in Malaysia.

The Takaful business in Malaysia, like the insurance business discussed above, is also regulated by BNM. In addition, Prudential Takaful is required to be a member of the Malaysian Takaful Association ('MTA'), an association for Takaful operators that seeks to improve industry self-regulation through uniformity in market practice and to promote a higher level of co-operation.

Takaful in Malaysia is considered to be part of mainstream mercantile law, and is subject to the civil court structure. It is not regulated by Shariah law in Shariah courts. However, the operations of a Takaful operator must conform to the rules and requirements of Shariah as regulated in the Takaful Act

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1984, which elevates the BNM's Shariah Advisory Council to the position of sole authority on Shariah matters. A Takaful operator is required to establish a Shariah advisory body approved by BNM to which BNM's Shariah Advisory Council will give guidance and advice on operations and business activities. Since 2004, BNM has issued a series of guidelines aimed at fostering the Takaful industry and promoting its orderly growth, including capital adequacy, financial reporting, stress testing and conduct of business rules around product disclosure, suitability and anti-money laundering.

Capital requirements

BNM issued the Takaful Operational Framework which came into force on 2 January 2012. The regulations further strengthen the operational and valuation requirements of Shariah law, such that the paid-up capital requirement is RM100 million. The regulator also published a new Risk Based Capital framework for Takaful on 30 October 2012. The framework aims to facilitate sound management of capital, aligned to the Takaful operator's risk profile. Full implementation is scheduled for January 2014 but Takaful operators have been required to submit quarterly and annual reports on a parallel basis from March 2013.

China CITIC-Prudential Life Insurance Company Limited

Overview

CITIC-Prudential Life Insurance Company Limited (Prudential's joint venture with CITIC) is authorised to conduct life insurance business in China. To date, CITIC-Prudential Life had business across China including the key markets of Guangdong, Beijing, Shanghai, Hubei, Shandong, Shejiang, Jiangsu, Tianjin, Guangxi, Fujian and Hebei.

The body responsible for regulation of the insurance sector is the Chinese Insurance Regulatory Commission ('CIRC'). CIRC reports directly to the State Council.

CIRC is authorised to conduct the administration, supervision and regulation of the Chinese insurance market, and to ensure that the insurance industry operates in a stable manner in compliance with the law. CIRC also has local offices in all 31 of the provinces and selected direct administrative cities and regions across the country which set and administer implementation rules and guidelines in the application of the regulations introduced by CIRC, and which regulate many aspects of the insurance companies' activities within the locations for which they are responsible, including conduct and licensing matters.

CIRC has focused specific attention on the area of risk prevention, with five identified lines of defense against risks, namely internal management and control systems, supervision of solvency adequacy, on-site inspection, fund management regulation and insurance security fund. In response to the global financial crisis, more importance has been attached to the supervision of internal control systems, corporate governance, and market conduct and information disclosure by insurance companies. A classification system has also been developed by the regulator to monitor risks in the industry. Under the system, insurance companies are classified into four groups based on the risk indicators relating to solvency margins, corporate governance, capital management, financial status and market conduct. Different administrative measures may be imposed on different groups.

The new Chairman of the CIRC has re-emphasised the importance of preventing sales malpractices and embarked on a major exercise of industry self-assessment and regulatory inspection aimed at evaluating and improving the effectiveness of controls over such activities. Further action is expected in this area both in the near future and over the coming years.

The People's Bank of China ('PBOC') is entrusted with responsibility and authority to regulate all anti-money laundering activities in China and has actively been developing rules and guidance, requiring insurance companies to abide by the PRC's main AML law and regulations in connection with capital

investment, transfers and set-up of new branches, and specify senior management's responsibilities on AML.

Capital requirements

The minimum registered paid-up capital of a foreign invested insurance company is RMB200 million. A similar requirement is imposed on a Chinese branch of a foreign insurance company. Both foreign invested insurance companies and Chinese branches of foreign insurance companies are required to maintain a solvency ratio that is not lower than 100 per cent. Under relevant PRC regulations, the solvency ratio is the ratio of actual capital to the minimum capital requirement applicable to the insurer pursuant to relevant regulations. The actual capital is the difference between the admitted assets and admitted liabilities. The CIRC requires solvency reports to be submitted quarterly, annually or *ad hoc* as required by the CIRC. Where an insurer is not able to meet its solvency requirement, it is required to immediately report to the CIRC.

In March 2012, the CIRC released its plan for the second generation of its solvency framework, to bring it closer to international norms within the next three to five years. Solvency and risk management requirements are expected to be enhanced, but it is too early to assess the impact on insurance companies.

Thailand Prudential Life Assurance (Thailand) Public Company Limited

Overview

Prudential Life Assurance (Thailand) Public Company Limited (PLT) holds a life insurance license and is authorised to offer life and general insurance products. This also includes an authorisation to offer products with an investment linked feature.

PLT is regulated and supervised by the Office of Insurance Commission ('OIC'),the independent regulatory organisation handling day-to-day insurance business affairs and reporting to the Ministry of Finance. The OIC has the power to manage and supervise insurance companies, protect insured persons and the general public, implement policies with respect to insurance funds, and regulate the professional conduct, qualifications and licensing of insurance brokers, agents and actuaries.

In respect of AML, all life insurance businesses are also regulated by the Anti-Money Laundering Office 'AMLO.' All suspicious reporting is to be made to Thailand's Financial Intelligence Unit ('FIU').

In the private sector, the Thai Life Assurance Association and the General Insurance Association play an active development role for their membership and support the insurance business as its representative bodies.

The OIC has a five-year insurance development plan in place covering 2010-2014 that aims to strengthen the Thai insurance system by enhancing standards to meet international norms and to prepare for greater liberalisation in the future. Consultations on proposed regulation focused on how banks and insurance companies sell insurance and investment-related products to their customers occurred in 2012. When implemented, such regulations are expected to require insurance firms to enhance internal systems and controls in firms. The Bank of Thailand regulations on bancasssurance came into effect in January 2013. Under these regulations banks are required to ensure that staff distributing insurance products possess the relevant competence around product knowledge, enhanced disclosure of product yields and the prohibition of bundling insurance products with bank products. It is anticipated that similar regulation for insurance companies will be issued during 2013.

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Capital requirements

Life insurers are required by law to maintain capital funds at the greater of two per cent of their insurance reserve or 50 million Thai Baht, but the OIC requires insurers to maintain capital funds of at least 150 per cent of this amount. An insurer that fails to maintain capital funds in line with OIC guidelines and does not take corrective action to address the deficiency will be subject to sanctions through restrictions on its investment and other business activities.

The 2008 amendments to the Life Insurance Act required the implementation of risk-based capital adequacy tests by 2011. Relating to this the OIC issued guidelines in 2011 requiring audited quarterly RBC returns to be filed with them.

Philippines Pru Life Insurance Corporation of UK

Overview

Pru Life Insurance Corporation of UK is licensed in the Philippines as a life insurance company and also permitted to offer health, accident and disability insurance.

The Insurance Code of the Philippines, as amended, ('Insurance Code') gives the power to supervise and regulate the operations and business of insurance companies to the Insurance Commission ('IC'). The IC is a government agency under the Department of Finance, and is headed by the Insurance Commissioner. IC regulation and supervision seeks, amongst other things, to ensure that adequate insurance protection is available to the public at a fair and reasonable cost and to ensure the financial stability of the insurance industry so that all legitimate claims of the insured public are met promptly and equitably, and to safeguard the rights and interests of the insured.

Capital Requirements

Any life insurance company existing, operating, or otherwise doing business in the Philippines with at least sixty percent (60%) foreign equity must meet a minimum capital requirement and also adopt an RBC Framework.

To strengthen the RBC regulatory framework, a new directive was also issued in 2012 requiring increased capitalization for both life and non-life insurance providers, with a minimum paid-up capital of Php250m (increasing to Php1bn by the end of 2020).

India ICICI Prudential Life Insurance Company Limited

Overview

ICICI Prudential Life Insurance Company Limited (Prudential's joint venture with ICICI in which Prudential has a 26 per cent share) is authorised to carry on long-term insurance business in India.

Insurance is subject to federal regulation in India. The Insurance Regulatory & Development Authority (the 'IRDA') is the key regulator for ICICI Prudential Life Insurance operations. The IRDA's duties include issuing certificates of registration to insurance companies, protecting the interests of policyholders, and regulating, promoting and ensuring the orderly growth of the insurance industry. Regulatory direction is currently focused on corporate governance and disclosures to stakeholders. The IRDA's regulations also encourage the sale of insurance to customers in rural parts of India.

There has been a significant volume of regulatory developments in India since 2010 designed to shift the emphasis of the industry away from products which are mostly investment oriented and encourage more traditional savings and protection. The most significant changes relate to product regulation of investment-linked policies known as unit-linked insurance policies (ULIPS) with initiatives to rationalise ULIP product features, including through increased minimum lock-in periods and terms and

requirements of minimum guaranteed rates of return and payouts. Regulatory initiatives or changes have also included streamlining of the product approval process and product rules for traditional products.

In late 2011, the Finance Ministry formed four committees to prepare a roadmap for the insurance industry, tasked to look into issues relating to insurance penetration, product development and the regulatory framework, these committees engage with industry bodies, ratings agencies and the Finance Ministry.

A number of developments aimed at fostering the growth of the insurance industry are underway. The IRDA is currently exploring tax incentives for life insurance and the Finance ministry is currently engaged in discussion with the industry. In October 2012, the cabinet approved an amendment to the Insurance Bill 2008 to raise the FDI from 26 per cent to 49 per cent, with the increase now pending approval by the Indian Parliament. In the same month, the IRDA also issued draft regulations on the Bancassurance business to help foster the growth of the insurance industry that would permit a bank to act as a corporate agent or a broker (the latter requiring the bank to terminate existing partnerships), and to also tie up with life, non-life and health insurers up to a maximum of 20 locations across India. This limits the outreach of ICICI Prudential Life's products and may hamper servicing of customers in provinces where the banks have no permissions to distribute these products.

The Reserve Bank of India and the IRDA recently initiated probes into allegations by an online Indian investigative media outlet that sales practices at certain Indian banks (including ICICI Bank) and insurance companies (including ICICI Prudential Life Insurance Company Limited) would have permitted or facilitated money-laundering transactions in violation of local law. It is too early to predict whether such allegations, some of which involve offers to sell insurance products (including those of ICICI Prudential Life Insurance Company Limited), might lead to additional regulatory actions against the implicated Indian insurance companies whose products were allegedly offered.

Capital Requirements

There are proposals to develop a risk based capital regime in India. Every insurer must maintain an excess of assets over liabilities and the Required Solvency Margin for an insurer is the higher of Rs.500 million or formulaic calculation of net premium or formulaic calculation of net claims.

Indonesia PT. Prudential Life Assurance

Overview

PT. Prudential Life Assurance is authorised to carry on long-term (for an indefinite period) insurance business in Indonesia. Prudential's operations in Indonesia are authorised to distribute life insurance products based on either conventional or Shariah principles, through agency and bancassurance (including direct marketing) channels. While the regulations for life products based on conventional principles are fully developed (in accordance with current market conditions), the government has promulgated new regulations in relation to life products with Shariah principles.

The insurance industry is regulated by the Insurance Bureau under the Capital Market and Financial Institution Supervisory Board ('Bapepam-LK') of the Ministry of Finance ('MoF'). Currently, Bapepam-LK is in the transitional period to becoming Otoritas Jasa Keuangan (OJK). OJK is the newly established financial sector regulator that is going to replace all Bapepam-LK functions, including Investment Management Bureau, insurance, pension funds, financing companies and banking industry supervision by Bank Indonesia (the Indonesian central bank). OJK became partially operational in January 2013, since taking over supervision of Non-Bank Financial Institutions (NBFIs). The transition of supervision of the banking sector is expected to be completed by end 2013.

The MoF issues decrees on, among other things, licensing of insurance companies, business conduct, auditing, solvency, fit and proper test for directors and commissioners of insurance companies,

Shariah insurance and Know Your Customer (KYC) principles. These decrees are usually supplemented by implementing regulations issued by the Bapepam LK.

The local Life Insurance Association ('AAJI') continues to act as a conduit between insurers and the MoF and Bapepam LK in terms of the development of new regulations and guidelines. Insurance sales forces are licensed by the AAJI.

The implementation of anti-money laundering controls in the insurance industry is monitored by the Indonesian Financial Transaction Reports and Analysis Center (the 'PPATK').

In January 2012, the MoF issued draft regulations governing product development and distribution which were implemented in the first quarter of 2013. Insurers are now required to develop and implement strategic product plans, including relevant risks to be integrated in the organisational risk management framework and adhere to detailed disclosure requirements relating to product sales and marketing materials.

Capital Requirements

The minimum capital requirement for insurers who operate in Indonesia was Rp 40 billion, which was increased to Rp 70 billion at the end of 2012 and will increase again to Rp 100 billion by 2014 to 'encourage tighter market consolidation.'

Japan PCA Life Insurance Company Limited ('PCA Life Japan')

Overview

The Financial Services Agency of Japan (the 'JFSA') regulates insurance companies and other financial institutions. In particular, the Insurance Business Division of the JFSA specifically undertakes the supervision of insurance companies. PCA Life Japan is licensed by the Prime Minister of Japan (who delegates most of the supervisory functions to the JFSA) as a life insurance company. PCA Life Japan ceased underwriting new policyholder contracts from 15 February 2010.

Capital Requirements

The Insurance Business Law requires insurance companies to demonstrate financial soundness by maintaining a solvency margin ratio of greater than 200% and a positive adjusted net capital balance. Any insurance companies failing to comply will be subject to administrative actions including business suspension.

The JFSA has recently revised and enhanced its inspection criteria regarding reinsurers' financial strength and its integrated risk management schemes.

Vietnam Prudential Vietnam Assurance Private Limited

Overview

Prudential Vietnam Assurance Private Limited is licensed and regulated by the Ministry of Finance of Vietnam (the 'MoF') as a life insurance company. An insurance company is not permitted to operate both life and non-life insurance at the same time, except in the case of a life insurance company that offers personal health and protection care insurance as a supplement to life insurance.

The Insurance Division of the MoF specifically undertakes the supervision of insurance companies. The fundamental principles of the operation of insurance companies are set out in the Insurance Business Law.

Generally, the Insurance Business Law and its guiding regulations focus on administrative supervision of insurance operations. In practice, the Insurance Business Law reserves most of its items

for insurance contracts (that is, for the terms and conditions of policies) in order to protect policyholders' interests. Furthermore, the MoF has issued the new regulation on bankruptcy procedures for insurers, securities and financial institutions in late 2008 to allow it to take timely intervention to control the solvency of insurance companies.

Anti-money laundering controls in the insurance industry are monitored by the Anti-Money Laundering Department under the Banking Inspection, State Bank of Vietnam.

Capital Requirements

10 out of the 11 Life insurance companies in Vietnam are foreign-owned, and influenced by the need to have funds of at least 600 billion dong (US $31 million) in capital a requirement beyond the reach of most Vietnamese owned companies.

Cambodia Prudential Cambodia

Prudential Cambodia was granted in-principle approval from Cambodia's Ministry of Economy and Finance in June 2012 to establish life insurance operations in that country. A representative office has been established in Phnom Penh and started selling life insurance policies in January 2013.

2. Regulation of investment and funds businesses and other regulated operations

Prudential conducts investment and fund businesses through subsidiaries or joint ventures in the following countries in Asia: Hong, Kong, Japan, Korea, Taiwan, The People's Republic of China, India, Singapore, Malaysia, Dubai, Vietnam and Indonesia. All operations are authorised and licensed by the relevant authorities, or exempted from licensing under the relevant regulations.

On 14 February 2012, the Asia Fund Management operations (except joint venture companies) was rebranded Eastspring Investments, and the new brand replaced a number of different business names that the asset management business had operated under across Asia.

All of the relevant authorities generally have broad supervisory and disciplinary powers, including, among others, the power to set minimum capital requirements, to temporarily or permanently revoke the authorization to carry on regulated business, to suspend registered employees/licensed representatives, and to invoke censures and fines for both the regulated business and its registered employees/licensed representatives. Although the detail of regulation varies, common features of the regulatory regimes in each jurisdiction tend to include investment restrictions, advertising codes, disclosure requirements in prospectuses and/or marketing materials, and requirements to seek unit holders' approvals in certain instances, provision of financial statements and other periodic disclosures to regulators, audits by regulators and so on.

Hong Kong

Products and services offered by Prudential in Hong Kong are regulated under separate statutory regimes by different regulatory bodies, including the Hong Kong Securities and Futures Commission ('HKSFC'), the Hong Kong Monetary Authority and the Mandatory Provident Fund Schemes Authority ('MPFA').

The MPFA regulates the compulsory Mandatory Provident Fund ('MPF'). In addition, the selling of MPF products by agents is regulated by the MPFA. The MPFA is responsible for the licensing and supervision of trustees who wish to administer MPF schemes and MPF intermediaries.

The Securities and Futures Ordinance ('SFO') and other subsidiary legislation govern the key regulatory requirements in Hong Kong relating to licensing requirements for persons carrying out regulated activities, including dealing in securities, advising on securities, fund management, market

conduct, disclosure of interests, offering document requirements for securities and products including mutual funds and unit trusts, as well as investment-linked assurance products. The HKSFC is the statutory body responsible for the administration of the SFO and the related subsidiary legislations and rules.

The Hong Kong branch of PAC is regulated by the HKSFC for its operations relating to investment linked products. It is also registered with the MPFA as a MPF corporate intermediary.

Eastspring Investments (Hong Kong) Limited, incorporated in Hong Kong, is a wholly owned subsidiary of Prudential Plc. It is licensed with the HKSFC and authorised to deal in and advise on securities and undertake asset management activities in Hong Kong. It also holds a QFII (Qualified Foreign Institutional Investors) license issued by the China Securities Regulatory Commission ('CSRC'). The company is also registered with the Korea Financial Supervisory Service (KFFS) as an offshore investment advisor for investment advisory business and investment discretionary management business. The funds registered in Hong Kong by Eastspring Investments (Hong Kong) are also registered in Macau with the Monetary Authority of Macau.

BOCI-Prudential Asset Management Limited ('BOCIP'), incorporated in Hong Kong, is a joint venture between Prudential Corporation Holdings Limited (36 per cent) and BOCI Asset Management Limited (64 per cent). BOCIP is licensed by the HKSFC and is authorised to deal in and advise on securities, advise on corporate finance, advise on futures contracts and undertake asset management activities. It is also registered with the MPFA as an MPF corporate intermediary. It also holds a QFII license issued by the CSRC. The investment funds registered in Hong Kong by BOCIP are also registered in Macau with the Monetary Authority of Macau.

BOCI-Prudential Trustee Limited is a joint venture between Prudential Corporation Holdings Limited (36 per cent) and BOC Group Trustee Company Limited (64 per cent). The company is incorporated in Hong Kong and is an approved trustee under the Mandatory Provident Fund Schemes Ordinance and an associated entity to the BOCIP under the SFO.

Japan

Eastspring Investment Limited (known until February 2012 as PCA Asset Management Limited) is registered with the Kanto Local Finance Bureau under the Financial Services Agency ('JFSA') to engage in (a) second financial instruments business, (b) investment management business, (c) investment advisory & agency business and (d) ancillary business under the Financial Instruments and Exchange Act ('FIEA')

The company is also a member of the Investment Trusts Association, Japan and the Japan Investment Advisers Association. Both associations are self-regulatory bodies under FIEA. Eastspring Investment Limited is required to comply with the policies and regulations issued by these associations, which are authorised to conduct on and off-site inspection in addition to the inspection conducted by the Securities and Exchange Surveillance Commission which is part of FSA.

Under its registration in respect of the second financial instruments business, the company is permitted to explain products being sold but cannot effect actual sales of Eastspring Investments Limited's funds directly to investors. It does not therefore set up or maintain customer accounts for purposes of investment in Prudential's funds or their settlement, which may only be opened at relevant distributors such as registered financial institutions and type one financial instruments business operators like securities companies.

Korea

Prudential conducts a fund business in Korea through an indirect, wholly-owned subsidiary, Eastspring Asset Management Korea Co. Ltd. The bodies responsible for the regulation of asset

management companies, investment advisers and discretionary management companies are the Financial Services Commission ('FSC') and its executive arm, the Financial Supervisory Service ('FSS').

Traditionally, the FSC in Korea has operated in a prescriptive manner with a significant amount of detailed regulation that asset management companies must comply with. In recent years, the style of regulation of the indirect investment industry has been changing in line with a more general trend towards liberalisation of financial services. In particular, the FSC has focused on deregulation in asset management and product design activities and shifted increasingly towards a principles-based regulatory regime.

Taiwan

The body responsible for regulation of securities investment trust enterprises ('SITE'), securities investment consulting enterprises ('SICE') and discretionary investment businesses is the Securities and Futures Bureau ('SFB') under the Financial Supervisory Commission ('FSC'). The SFB is responsible for promulgating laws, regulations and policies in relation to these business areas.

Eastspring Investment Trust Co. Ltd is registered as a SITE with the FSC. It is compulsory that all SITEs are members of the Securities Investment Trust and Consulting Association ('SITCA'), a self-regulatory organisation ('SRO'). SITCA supports the regulatory and administrative operations entrusted to the SFB by adopting self-regulatory rules and overseeing self-regulation by its members, establishing a membership disciplinary framework and carrying out matters that the SFB has authorised it to handle, such as previewing product filing documents before submission for the SFB's final review. SITCA also acts as liaison between the SFB and its members for matters of business development.

China

CITIC-Prudential Fund Management Company Limited, a joint venture between Prudential and CITIC Group (China International Trust and Investment Corporation), is regulated by the China Securities Regulatory Commission ('CSRC'). The CSRC supervises the establishment of fund management companies ('FMCs') and the launch of securities investment funds.

The legislative framework of China's fund industry comprises the China Securities Investment Funds Law (the 'Fund Law') and a set of ancillary regulations (the 'Fund Regulations'). While the Fund Law and Fund Regulations articulate the rules and requirements which must be adhered to by all FMCs, the supervisory approach of CSRC, to a certain extent, is also principles- based. The Chinese authorities aim to protect the legitimate rights and interests of investors and other relevant parties, and thereby to promote the healthy development of securities investment funds and securities markets. The CSRC has slowly started a process of deregulation. One major deregulation measure in 2010 was to lift the control over product approvals, which enables FMCs to launch more fund products.

The National People's Congress ('NPC'), China's top legislator, has approved the revised Fund Law to take effect in June 2013. The key proposed changes include registration of hedge funds, which will for the first time provide hedge funds opportunity to register with the regulator, as well as having a regulatory framework in place. The changes will also allow individual ownership of fund management companies, which will help to diversify the shareholding structure of EMCs and makes ESOP(s) possible as incentive schemes. Lastly, the changes will lift personal trading and investment restrictions. The changes to the investment restrictions will provide funds with more flexibility in investment activities and offer more opportunity for product innovation.

India

ICICI Prudential Asset Management Company Limited ('AMC'), a joint venture between Prudential and ICICI Bank Ltd., is approved by the Securities and Exchange Board of India ('SEBI') to act as

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Investment Manager of ICICI Prudential Mutual Fund (the 'Fund'). The Fund was set up as a Trust sponsored by Prudential (through its wholly owned subsidiary Prudential Corporation Holdings Ltd) and ICICI Bank Ltd. ICICI Prudential Trust Limited (the 'Trust Company'), is the Trustee to the Fund.

Mutual funds in India are comprehensively regulated by the guidelines and statutes promulgated under the SEBI (Mutual Funds) Regulations, 1996, the Indian Trusts Act, 1882, relevant provisions of the Companies Act 1956 and other applicable laws.

All mutual funds are required to be in the form of trusts. The trustee functions are carried out by separately established trust companies or boards of trustees. In all cases, the trust deed must be approved by the SEBI. AMC has obtained registration from the SEBI to act as a Portfolio Manager under SEBI (Portfolio Managers) Regulations 1993. AMC under its portfolio management license has also been appointed as the investment manager by the Trust for managing the scheme launched under the ICICI Prudential Venture Capital Fund.

In 2005, SEBI confirmed it had no objection to AMC undertaking Advisory Services to Offshore Funds. AMC has commenced the provision of Advisory Services and has also applied to set up a venture capital fund ('VCF') in India.

A key regulatory developments in 2012 was to permit mutual funds/asset management companies to charge service tax on investment and advisory fees to the scheme in addition to the maximum limit of TER, with service tax on other than investment and advisory fees, if any, borne by the scheme within the maximum limit of TER.

Singapore

Eastspring Investments (Singapore) Limited ('Eastspring Singapore'), an indirect wholly owned subsidiary of Prudential plc, has been issued a Capital Markets Services ('CMS') license, to conduct the regulated activities of fund management and dealing in securities by the MAS. In addition, Eastspring Singapore is admitted by the Central Provident Board ('CPF') as a Fund Management Company ('FMC') under the CPF Investment Scheme ('CPFIS') and may manage unit trusts included under the CPFIS. It is also registered with the U.S. Securities and Exchange Commission as a registered investment adviser under the Investment Advisers Act of 1940; the Financial Services Commission of South Korea, as a Cross border Investment Advisor under the Capital Market Consolidation Act and SEBI, under the SEBI (Foreign Institutional Investors) Regulations, 1995. Eastspring Singapore is also registered as a Qualified Institutional Investor with Japan's Financial Supervisory Authority, and is relying on the Class Order Exemption CO 03/1102 from the Australian Securities and Investments Commission for exemption from the need to hold an Australian financial services license for provision of services to wholesale clients in Australia.

Prudential Property Investment Management (Singapore) Pte. Ltd. ('Prupim SGP') is an indirect wholly-owned subsidiary of Prudential plc. It is a real estate fund management company, and operates in Singapore as an exempt fund manager and exempt financial adviser under the Securities and Futures Act and the Financial Advisers Act respectively. As an exempt fund manager and exempt financial adviser, Prupim SGP provides services to not more than 30 qualified investors (for fund management services) and accredited investors (for financial advisory services).

Key regulatory developments in 2012 included the following:

- A new regime on disclosure of interests in entities listed on the Singapore Exchange Securities Trading Limited ('SGX') came into effect, streamlining and enhancing the disclosure of interests in SGX-listed entities;

- An enhanced regulatory regime for FMCs took effect under which all FMCs have to meet enhanced business conduct and capital requirements; and

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MAS introduced a regulatory framework for credit rating agencies, under which they will be regulated under the Securities and Futures Act.

New requirements for mandatory reporting of certain OTC derivative transactions were also introduced. MAS has proposed requiring central clearing for two initial types of instruments, US dollar interest rate swaps ('IRS'), Singapore dollar IRS and non-deliverable forwards ('NDF') in selected Asian currencies (if one leg of the contract is booked in Singapore) with approved central clearing party and mandatory reporting of such transactions to trade repositories if it exceeds a certain clearing/reporting threshold.

Malaysia

Eastspring Investments Berhad (formerly known as Prudential Fund Management Berhad) was incorporated in November 2000 and is a wholly owned subsidiary of a Malaysian incorporated company, Nova Sepadu Sdn Bhd, which is in turn a subsidiary of Prudential.

Eastspring Al Wara' Investments Berhad (formerly known as Prudential Al-Wara' Asset Management Berhad)was incorporated in June 2009 and is a wholly owned subsidiary of Prudential Corporation Holdings Ltd. Eastspring Al Wara' Investments Berhad is an Islamic Shariah compliance asset management company.

Eastspring Investments Berhad and Eastspring Al Wara' Investments Berhad are both regulated by the Securities Commission (the 'SC'), a statutory body formed under the Securities Commission Act 1993 (SCA) and Capital Markets Services Act 2007 (CMSA), which reports to the Minister of Finance. The SC pursues an intensive and comprehensive approach to the oversight of firms and markets.

The SC has recognised the Federation of Investment Managers Malaysia (FIMM) as a self-regulatory organisation (SRO) for the unit trust industry. As an SRO, FIMM will regulate its own members while also ensuring that investors are protected and public interests are upheld. This complements the SC's efforts to ensure a more efficient and effective regulatory regime without compromising investor protection.

In addition, under a notable 2011 reform, the key Guidelines on Compliance Function for Fund Managers were revised to enhance client asset protection and raise compliance standards to safeguard the interests of investors. This included obligations on fund management companies to make adequate arrangements to safeguard clients' ownership rights on all clients' assets, ensure that the client assets are properly accounted for at all times and perform an annual evaluation of custodians.

Dubai

Eastspring Investments Limited ('Eastspring Investments Dubai') was incorporated in the Dubai International Financial Centre ('DIFC') in September 2006. Eastspring Investments Dubai is an ultimately wholly-owned subsidiary of Prudential Plc. Eastspring Investments Dubai is regulated by the Dubai Financial Services Authority ('DFSA'), which is the independent regulator for DIFC. Eastspring Investments Dubai holds a license for arranging credit or deals in investments, advising on financial products or credit and has a retail endorsement on its license. The supervisory approach of DFSA, to a large extent, is risk-based.

In June 2012, DFSA announced the enactment of two new laws which, among other things, brought about a number of significant changes to prospectus disclosure, what activities constitute an offer, market misconduct provisions and corporate governance. The new laws are designed to promote investor protection in a manner that better aligns the DIFC to international standards.

New regulations for mutual funds came into effect on 26 August 2012. All marketing of foreign funds will need to occur through a local promoter and all such funds will need to be approved by the

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Emirates Securities and Commodities Authority ('ESCA'). There is a grace period of one year for firms currently servicing the market. Eastspring Investments Dubai markets funds through platforms operated by local distributors. These distributors are in the process of having all funds on their platforms approved. We will need to monitor this process and maintain contact with trade bodies to ensure we fully understand how this regulation is being implemented in practice.

Vietnam

Eastspring Investments Fund Management Limited Liability Company ('Eastspring Investments Vietnam') was established and operates under a business registration for securities investment fund management and securities portfolio management.

Prudential Vietnam Assurance Private Limited is the sole owner of Eastspring Investments Vietnam.

Eastspring Investments Vietnam is regulated by the State Securities Commission of Vietnam ('SSC'), which is overseen by the Ministry of Finance ('MoF'). In keeping with its mandate to establish and develop the securities markets, the SSC supervises the organisation, and operation of securities investment funds and fund management companies.

Indonesia

PT. Eastspring Investments Indonesia ('Eastspring Investments Indonesia') was established on 24 March 2011, owned 99% by Eastspring Investments (Hong Kong) Limited and 1% by PT. Prudential Life Assurance. Eastspring Investments Indonesia received its Asset Management Company license on 25 April 2012, which was granted Bapepam-LK. Eastspring Investments Indonesia is currently exclusively regulated and supervised by the Investment Management Bureau of Bapepam-LK. (As discussed above under 'Regulation of insurance business *Indonesia PT Prudential Life Assurance*', Bapepam-LK is in the transitional period to becoming OJK.) This operating license authorised Eastspring Investments Indonesia to perform fund management of collective investment portfolios and discretionary fund portfolios. In addition, Eastspring Investments Indonesia is also allowed to provide investment advisory services regarding the purchase and sale of securities by its clients but without receiving any financial compensation. This condition of non-compensation for the investment advisory service shall apply as long as Eastspring Investments Indonesia has no investment advisory license.

United States

Eastspring Investments Incorporated ('Eastspring Investments USA') was incorporated in the State of Delaware in April 2012 and the business was launched in August 2012. Eastspring Investments USA is an indirect wholly owned subsidiary of Prudential plc.

Eastspring Investments USA is not engaged in providing investment management services or in broker-dealer activity. On behalf of its affiliate, Eastspring Investments (Singapore) Ltd. ('Eastspring Investments Singapore'), Eastspring Investments USA serves as a 'solicitor' as that term is defined under the provisions of the Investment Adviser Act of 1940 and the rules thereunder. Eastspring Investments Singapore is registered with the U.S. Securities and Exchange Commission as a registered investment adviser, and, although its solicitation activity is regulated under the Investment Adviser Act of 1940, Eastspring Investments USA is not required to be separately registered with the U.S. Securities and Exchange Commission.

Certain US states and local governmental bodies may require that individuals engaged in solicitation activity be either registered or otherwise qualify for an exemption to be soliciting in that jurisdiction. Based on its solicitation activity on behalf of Eastspring Investments Singapore, Eastspring Investments USA is subject to the solicitation restrictions and filings of those individual states, as applicable.

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US Supervision and Regulation

Overview

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

Insurance regulatory authorities in the jurisdictions in which Jackson does business require it to file detailed quarterly and annual financial statements, and these authorities have the right to examine its operations and accounts. In addition, Jackson is generally subject to federal and state laws and regulations that affect the conduct of its business. New York and Michigan require their state insurance authorities to conduct an examination of an insurer under their jurisdiction at least once every five years.

In 2012, the New York insurance authorities commenced a triennial examination of Jackson National Life of New York for the examination period of 1 January 2009 through 31 December 2011. Michigan insurance authorities commenced an examination of Jackson in 2012 for the period 1 January 2009 through 31 December 2011. There have been no material findings to date in the examinations by the Michigan and New York authorities.

Jackson's ability to pay shareholder dividends is limited under Michigan insurance law. The Commissioner of the Michigan Office of Financial and Insurance Regulation (the 'Michigan Insurance Commissioner') may limit, or not permit, the payment of shareholder dividends if the Michigan Insurance Commissioner determines that an insurer's surplus, as regards policyholders, is not reasonable in relation to its outstanding liabilities and is not adequate to meet its financial needs as required by Michigan insurance law. Jackson must report any shareholder dividends to the Michigan Insurance Commissioner before they can be paid. In the case of an extraordinary shareholder dividend or distribution, an insurer may not pay the dividend or distribution until 30 days after the Michigan Insurance Commissioner has received notice of the declaration and has not disapproved, or has approved, the payment within that period. For this purpose, an extraordinary dividend or distribution means any dividend or distribution of cash or other property where the fair market value, together with that of other dividends or distributions that an insurer made within the preceding twelve months, exceeds the greater of 10 per cent of the insurer's surplus, as regards policyholders as of 31 December of the immediately preceding year, or the net gain from operations of the insurer, not including realised capital gains, for the prior year. In 2010, 2011 and 2012, Jackson paid shareholder dividends to Prudential plc of US$275.0 million, US$530.0 million, and US$400.0 million respectively.

State regulators also require prior notice or regulatory approval of changes in control of an insurer or its holding company and of certain material transactions with affiliates. Under New York and Michigan insurance laws and regulations, no person, corporation or other entity may acquire control of an insurance company or a controlling interest in any parent company of an insurance company, unless that person, corporation or entity has obtained the prior approval of the regulator. For the purpose of each of New York and Michigan law, any person acquiring, directly or indirectly, 10 per cent or more of the voting securities of an insurance company is presumed to have acquired 'control' of the company. To obtain approval of any change in control, the proposed acquirer must file an application with the New York Superintendent of Insurance or the Michigan Insurance Commissioner, as appropriate. This

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application requires the proposed acquirer to disclose, among other information, its background, financial condition, the financial condition of its affiliates, the source and amount of funds by which it will effect the acquisition, the criteria used in determining the nature and amount of consideration to be paid for the acquisition, proposed changes in the management and operations of the insurance company and other related matters. The Michigan Insurance Commissioner can grant an exemption from filing an application if an acquisition does not have the effect of changing or influencing control.

On 4 September 2012, with applicable regulatory approvals, Jackson completed the purchase of SRLC America Holding Corp ('SRLC') from Swiss Re Life Capital Ltd. ('Swiss Re') for a consideration of US$587 million which is subject to finalisation of completion procedures. Reassure America Life Insurance company (REALIC), an Indiana domiciled life insurer, was a wholly owned subsidiary of SRLC and the primary business entity under SRLC prior to the transaction. Certain REALIC business was excluded from the purchase through 100 per cent coinsurance transactions executed prior to the sale between REALIC and Swiss Re and its affiliates. Under the Michigan insurance law, value of business acquired ("VOBA") is reported as an admitted asset if certain criteria are met. In relation to the acquisition of REALIC and pursuant to Michigan insurance law at 31 December 2012, Jackson reported approximately US$470.1 million of statutory basis VOBA, which is fully admissible. Accordingly, the acquisition had no impact on Jackson's statutory basis capital and surplus at the acquisition date. On 31 December 2012, with applicable regulatory approvals, REALIC was merged with and into Jackson.

Guaranty associations and similar arrangements

Each of the 50 states of the United States, the District of Columbia and the Commonwealth of Puerto Rico has laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. These associations and arrangements provide certain levels of protection to policyholders from losses under insurance policies issued by insurance companies that become impaired or insolvent. Typically, these associations levy assessments, up to prescribed limits, on member insurers on a basis that is related to the member insurer's proportionate share of the business in the relevant jurisdiction of all member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Some jurisdictions permit member insurers to recover assessments that they paid through full or partial premium tax offsets, usually over a period of years. In 2012, Jackson increased its reserve for future guarantee fund assessments by $20.1 million as a result of the announced liquidation of the Executive Life Insurance Company of New York. Prudential Group estimated its reserve for future guarantee fund assessments for Jackson to be US$23 million at 31 December 2011. Prudential estimated its reserve for future guarantee fund assessments for Jackson to be US$39.6 million at 31 December 2012. 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, real estate, derivative instruments and other invested assets. The reserve is designed to provide for a normalised level of future losses based on the credit rating of each individual investment. The level of reserves is based on both the type of investment and its rating. Contributions to the reserve may result in a reduction in Jackson's unassigned surplus, which, in turn, may reduce funds available for shareholder distributions. The extent of the impact of the asset valuation reserve on Jackson's statutory surplus depends in part on the future composition of the investment portfolio.

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Interest maintenance reserve

State regulators generally require that insurers establish an interest maintenance reserve to defer non-credit-related realised capital gains and losses, net of taxes, on fixed income investments (primarily bonds, derivative instruments and mortgage loans) which are amortised into net income over the estimated remaining periods to maturity of the investments sold and to defer material gains or losses, net of taxes, resulting from market value adjustments on policies and contracts backed by assets carried at book value. The extent of the impact of the interest maintenance reserve on earnings and surplus depends on the amount of future interest rate-related realised capital gains and losses on fixed maturity investments, derivatives and mortgage loans and deferred gains or losses resulting from market value adjustments on policies and contracts backed by assets that are valued at book value.

The National Association of Insurance Commissioners ratios

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners annually calculates 12 financial ratios to assist state regulators in monitoring the financial condition of insurance companies. A usual range of results for each ratio is used as a benchmark and departure from the usual range on four or more of the ratios can lead to inquiries from individual state insurance departments. In 2012, none of Jackson's ratios fall outside the usual range.

Policy and contract reserve sufficiency analysis

State insurance laws require life insurance companies to conduct annually an analysis of the sufficiency of its life and annuity reserves. A qualified actuary must submit an opinion that states that the reserves, when considered in the light of the assets that an insurance company holds with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurance company. If a qualified actuary cannot provide such an opinion, then the insurance company must set up additional reserves by moving funds from surplus. The 2011 opinion has been submitted to the Michigan Office of Financial and Insurance Regulation without any qualifications.

Jackson's capital and surplus

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

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

As a Michigan domiciled insurer, Jackson is subject to a prescribed accounting practice that, under certain circumstances, allows an insurer to include the 'value of business acquired' as an admitted asset in excess of the amount allowed under NAIC guidance. At 31 December 2012, as a result of the acquisition of REALIC, Jackson has admitted US$242 million of value of business acquired in excess of the amount allowed under NAIC guidance.

Jackson has received approval from the Michigan Office of Financial and Insurance Regulation regarding the use of a permitted accounting practice. This permitted practice allows Jackson to carry certain interest rate swaps at book value as if statutory hedge accounting were in place instead of at fair value as would have been otherwise required. The permitted practice is effective 31 December 2012

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and expires with the period ending 30 September 2013 unless extended by the Michigan Insurance Commissioner. The effects of this permitted practice may not be considered by the company when determining the surplus available for dividends, nor the nature of dividends as ordinary or extraordinary.

Risk-based capital

The National Association of Insurance Commissioners has developed risk-based capital standards for life insurance companies as well as a model act for state legislatures to enact. The model act requires that life insurance companies report on a risk-based capital formula standard that they calculate by applying factors to various asset, premium and reserve items and separate model based calculations of risk associated primarily with variable annuity products. The risk-based capital formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk, market risk and business risk. The National Association of Insurance Commissioners designed the formula as an early warning tool to identify potentially inadequately capitalised companies for purposes of initiating regulatory action.

Any state adopting the model act gives the state insurance commissioner explicit regulatory authority to require various actions by, or take various actions against, insurance companies whose adjusted capital does not meet minimum risk-based capital standards. The Michigan Office of Financial and Insurance Regulation takes into account the National Association of Insurance Commissioners' risk-based capital standards to determine compliance with Michigan insurance law.

At 31 December 2012 the Company's total adjusted capital under the National Association of Insurance Commissioners' definition substantially exceeded Michigan standards.

Regulation of investments

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

Implementation of US Foreign Account Tax Compliance Act ('FATCA') provisions

Although the insurance business is regulated on a State level, US federal tax legislation and rules, including those relating to the insurance industry or insurance products, can have a significant impact on Prudential's business. Tax legislation and rules, and their interpretation, may change, possibly with retrospective effect, and proposals that would affect such changes are debated periodically by the US Congress.

Legislation incorporating provisions referred to as FATCA was passed in the US on 18 March 2010. The legislation and subsequent final regulations released in January 2013, requires Foreign Financial Institutions (FFIs) (such as Prudential plc and many of its subsidiaries) to enter into an FFI agreement, which requires the FFI to undertake due diligence procedures to identify and provide information on accounts held by US persons and US-owned foreign entities, or otherwise face a 30 per cent withholding tax on certain payments made to the FFI. In addition, FFIs that have entered into an FFI agreement may be required to withhold on certain payments made to FFIs that have not entered into an FFI Agreement, account holders who fail to provide sufficient information to classify an account as a US or non-US account, and US account holders who do not agree to the FFI reporting certain account related information to the IRS.

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Since 2012, the US Treasury has been negotiating intergovernmental agreements (IGA) with a number of countries which will result in those countries embedding the FATCA provisions into their domestic law. This development should have the added benefit of significantly reducing any withholding obligations on payments by US companies or FFIs to other companies or customers in these IGA countries. On 12 September 2012, the United Kingdom and the United States entered into an IGA which is expected to be implemented into UK law as part of the Finance Bill 2013 and related regulations. Prudential plc will be subject to the information collection and sharing required under this IGA, although non-UK branches of Prudential plc and non-UK subsidiaries of Prudential plc that are FFIs will not be subject to the UK-US IGA. These non-UK branches and subsidiaries will instead be required to either comply with an IGA in their home jurisdictions (if any), or comply with the FATCA provisions and final regulations. Any applicable IGA may require compliance with the FATCA provisions and final regulations, as modified by the relevant IGA.

FATCA will have an impact on many of Prudential's non-US businesses in the UK and Asia, and will require a review and enhancement of existing practices to ensure FATCA compliance. A Group-wide project has been set up by Prudential to manage the implementation of the new practices. All of Prudential's businesses have established formal project structures to deliver the requirements within the timescales.

The start date for implementation of the FATCA regime, including withholding on certain US source payments and the implementation of certain account diligence procedures, was recently changed from 1 January 2013 to 1 January 2014 and certain provisions may be further delayed. Complying with the required identification, withholding and reporting obligations is expected to require significant review and focus in an FFI's compliance and reporting framework. We are following developments regarding FATCA closely, and are coordinating with all relevant authorities.

USA Patriot Act

The USA Patriot Act, enacted in 2001, includes numerous provisions designed to fight international money laundering and to block terrorist access to the US financial system. The US Treasury Department has issued a number of regulations implementing the Patriot Act that apply certain of its requirements to financial institutions including broker dealers and insurance companies. Among other things, the regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. Jackson and, to the extent applicable, certain of its affiliates, have established policies and procedures to ensure compliance with the Patriot Act's provisions and the Treasury Department regulations.

Securities laws

Jackson, certain of its affiliates and certain policies and contracts that Jackson issues are subject to regulation under the federal securities laws administered by the US Securities and Exchange Commission (the 'SEC'). The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations and (in the case of broker dealers) to impose capital and related requirements. Jackson may also be subject to similar laws and regulations in the states in which it provides investment advisory services, offers the products described above or conducts other securities-related activities.

Jackson National Asset Management, LLC ('JNAM') is registered with the SEC as an investment adviser pursuant to the Investment Advisers Act of 1940, as amended (the 'Investment Advisers Act'). JNAM is registered as a transfer agent pursuant to the Securities Exchange Act of 1934, as amended (the 'Securities Exchange Act'). The investment companies (mutual funds) for which JNAM serves as an investment adviser are subject to SEC registration and regulation pursuant to the Securities Act of 1933,

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as amended (the 'Securities Act'), and the Investment Company Act of 1940, as amended (the 'Investment Company Act'). Certain of the mutual funds advised by JNAM underlie variable products offered by Jackson. In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product is organised as a separate account that is a unit investment trust.

Effective 31 December 2012, the U.S. Commodity Futures Trading Commission ('CFTC') eliminated an exclusion previously available to the mutual funds from the definition of a 'commodity pool' under the Commodity Exchange Act ('CEA'). Consequently, certain of the mutual funds became a commodity pool and became subject to the requirements of the CEA and the rules of the CFTC promulgated thereunder. As of 1 January 2013, JNAM is registered with the CFTC and the National Futures Association ('NFA') as a 'commodity pool operator' and is acting as a 'commodity pool operator' with respect to the operation of certain of the mutual funds as 'commodity pools' under and pursuant to the CEA, as applicable. The full impact of these new requirements on JNAM and the mutual funds is uncertain at this time. However, the new requirements will cause JNAM and the mutual funds to incur additional regulatory compliance and reporting expenses. The effects of these regulatory changes could reduce investment returns or harm the mutual fund's ability to implement its investment strategy.

Curian Capital, LLC ('Curian Capital') is registered with the SEC pursuant to the Investment Advisers Act and is also registered or notice filed in all applicable states. Curian serves as an investment adviser to certain investment companies. The investment companies (mutual funds) for which JNAM serves as an investment adviser are subject to SEC registration and regulation pursuant to the Securities Act and Investment Company Act. Certain of the mutual funds advised by Curian Capital underlie variable products offered by Jackson. In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product is organised as a separate account that is a unit investment trust.

As of 1 January 1, 2013, Curian Capital is registered with the CFTC and the NFA as a 'commodity pool operator' and is acting as a 'commodity pool operator' with respect to the operation of certain of the mutual funds as 'commodity pools' under and pursuant to the CEA, as applicable. The full impact of these new requirements on Curian Capital and the mutual funds is uncertain at this time. However, the new requirements will cause Curian Capital and the mutual funds to incur additional regulatory compliance and reporting expenses. The effects of these regulatory changes could reduce investment returns or harm the mutual fund's ability to implement its investment strategy.

Curian Clearing, LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Curian Clearing, LLC is a member firm of the Financial Industry Regulatory Authority (the 'FINRA'), subject to its supervisory and regulatory requirements.

Jackson National Life Distributors LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Jackson National Life Distributors LLC is a member firm of the FINRA, subject to its supervisory and regulatory requirements.

National Planning Holdings, Inc. ('NPH') owns four retail broker dealers, being IFC Holdings, Inc. (doing business as INVEST Financial Corporation), ('IFC'), Investment Centers of America, Inc ('ICA'), National Planning Corporation ('NPC') and SII Investments, Inc. ('SII'). These entities conduct business as securities broker-dealers, investment advisers, and insurance agencies (or affiliated with insurance agencies), and are licensed and qualified to transact business pursuant to their respective registration on licensure with the SEC, state securities and insurance authorities, and membership with FINRA and the

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Municipal Securities Rulemaking Board. NPC, SII, and ICA are also registered with the CFTC, and are members of the NFA for purposes of commodities and futures trading.

Prudential also conducts certain of its US institutional investment management activities through PPM America, Inc., which is registered with the SEC as an investment adviser under the Investment Advisers Act. PPM America serves as the investment adviser to Jackson and as the primary institutional investment adviser for certain Prudential subsidiaries, including The Prudential Assurance Company Limited. PPM America also acts as sub-adviser to certain US and foreign advisers affiliated with Prudential with respect to certain US portfolios of accounts or products sponsored or managed by such affiliates, including US mutual funds, UK-based pooled investment vehicles, a Luxembourg-based SICAV, Japanese investment trusts, and other similar vehicles. PPM America also serves as an investment adviser to other affiliated and unaffiliated institutional clients such as CDOs or similar structured vehicles and private investment funds (in which PPM America affiliates such as Prudential UK entities and Jackson are generally investors), and a limited number of other unaffiliated accounts. The US mutual funds for which PPM America serves as sub-adviser are subject to regulation under the Securities Act and the Investment Company Act, and other similar vehicles organised outside of the US may also be subject to regulation under applicable local law.

PPM America and certain of its subsidiaries are subject to various levels of regulation under the federal securities laws that the SEC administers as well as state securities laws. In connection with providing investment advisory services to certain of its clients, PPM America may also be subject to regulation under applicable foreign laws.

To the extent that PPM America or the NPH broker-dealers manage accounts with assets of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ('ERISA'), or the Internal Revenue Code, they may be subject to certain restrictions imposed by ERISA or the Internal Revenue Code. Such restrictions are summarised in 'Employee Benefit Plan Compliance' in the Section below. The US Department of Labor (the 'Department of Labor') and the US Internal Revenue Service have interpretive and enforcement authority over the applicable provisions of ERISA and the Internal Revenue Code.

Disclosure obligations under the US Securities Exchange Act and in particular under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012

Under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, which added Section 13(r) of the US Securities and Exchange Act of 1934, we are required to disclose certain of our activities and those of our affiliates related to Iran and to persons sanctioned by the United States under programs relating to terrorism and proliferation of weapons of mass destruction that occurred in the twelve-month period covered by this report.

Two of our non-US affiliates have engaged in transactions with persons sanctioned by the United States under Executive Order 13224, relating to terrorism. These transactions were entered into in compliance with laws and regulations applicable to the relevant affiliates. The first individual took out a one-off takaful certificate (a Shariah compliant life policy) with our Malaysian insurance subsidiary in October 2011. It was discovered in March 2012 through automated checking that his name matched various sanctions lists. The policy was for RM600 per month and RM 7,200 was paid for the year in 2012 (equivalent to around US$193 and US$2,316 respectively). The matter was reported to the Malaysian governmental sanctions authority, the Bank Negara Malaysia Financial Intelligence Unit, in March 2012.

The second individual is a beneficiary to three life insurance policies in his wife's name, the first taken out in December 2010 and two others taken out in November 2011 with our Indonesian insurance subsidiary. The first policy has a monthly premium of Rp 500,000 (around US$51) with premiums paid of Rp 6,000,000 paid for the year in 2012 (approximately US$612), the second and third are also for

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Rp 500,000 per month each with Rp 6,000,000 paid into each policy in 2012. The person was identified as a sanctioned individual in July 2012, and the matter was notified to the Indonesian governmental sanctions authority, the Indonesia FIU (PPATK), in August 2012. All 3 policies remain in force, but payments out will only be made in accordance with applicable law.

As the provisioning of insurance liabilities is undertaken on a portfolio as a whole basis, it is not practical to estimate the 2012 net profits on the contracts referred to above. We do not intend to engage in further new business dealings with these individuals.

In the UK, the Prudential Assurance Company Ltd operates a pension scheme for employees of the UK branch of government-owned Iranian bank. A total of 58 scheme members are receiving benefits, with 49 deferred members. All members are inactive in that no member or scheme contributions are being made or were made in 2012. The scheme is closed to new members. Due to the long term nature of a pension scheme it is not practical to advise the net profit, but the fund value at 31 December 2012 stood at £5,510,527.00. In return for administering the scheme there are standard Prudential scheme charges: an annual fee of £692, plus £11 per member, £56 per quote and a Trustee Accounts charge (£1,849.50 currently), all subject to 20 per cent Value Added Tax and an annual review. The annual invoice submitted for the annual period to 31 July 2012 was for £4,675.80 (including VAT). In addition to this an Annual Management Charge of 1.25 per cent is reflected in the fund value. The UK governmental sanctions authority, HM Treasury, has been informed of this arrangement and in 2008 advised us that following an analysis of the deeds, the fund is not owned, held or controlled by the bank. Payments out of the fund have been approved by HM Treasury through a licence. There are no plans to discontinue with this contract in light of this licence.

Employee benefit plan compliance

Jackson issues certain types of general account stable value products, such as GICs and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. Many of these plans are retirement plans that are subject to the fiduciary standards of ERISA and that are tax-qualified under the Internal Revenue Code. As such, Jackson may be subject to certain restrictions imposed by ERISA and taxes imposed by the Internal Revenue Code. These restrictions include:

- the requirement under ERISA that fiduciaries must perform their duties solely in the interests of ERISA plan participants and beneficiaries,
- the requirements under ERISA that fiduciaries may not engage in 'conflict of interest' transactions, and
- the requirements under ERISA that a fiduciary may not cause a covered plan to engage in certain 'prohibited transactions' with certain persons who provide services to the plan or are affiliated with the plan sponsor or a plan service provider.

In general, the Internal Revenue Code imposes taxes on persons involved in certain of the transactions described above.

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

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

In 1993, in John Hancock Mutual Life Insurance Company v. Harris Trust & Savings Bank, the US Supreme Court held that a portion of the funds held under a certain type of general account annuity

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contract did not constitute a 'guaranteed benefit policy' within the meaning of ERISA, a holding which potentially exposes insurers with similar types of contracts to the application of ERISA's fiduciary and prohibited transaction provisions in connection with the management of assets in their general accounts.

Although no assurances can be given, Jackson believes that none of its contracts are of the type to which the holding in Harris Trust would be applicable. Moreover, the Department of Labor has issued PTE 95-60, which generally exempts external, unaffiliated investment transactions from ERISA's prohibited transaction provisions. If the Harris Trust holding is applied to its contracts, Jackson would be subject to ERISA's fiduciary and prohibited transaction provisions described above.

Financial services regulatory and legislative issues

In the US, the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 ('The Dodd Frank Act') which represents a comprehensive overhaul of the financial services industry within the United States, was enacted in July 2010. The full impact of the Dodd Frank Act on Prudential's businesses is not currently clear, however, as many of its provisions have a delayed effectiveness and/or require rulemaking by various US regulators over the coming years.

The Dodd Frank Act vests a newly created Financial Stability Oversight Council ('the Council') with the power to designate systemically important institutions which will be subject to special regulatory supervision and other provisions intended to prevent or mitigate the impact of future disruptions in the US financial system. If Prudential is designated as a systemically important institution, its US operations may be subject to heightened prudential standards to be administered by the US Federal Reserve Board, including, amongst other things, heightened capital, leverage and liquidity standards, risk management requirements, concentration limits, resolution plans and stress tests, and potential discretionary requirements relating to contingent capital, enhanced public disclosure and short term debt limits. This same analysis may also be applied to Jackson.

Rules and guidance outlining the manner in which the Council will determine which companies should be so designated were adopted in April 2012. The rules set forth a three-stage process of increasingly in-depth evaluation and analysis, drawing on both qualitative and quantitative information (but preserving significant Council discretion). The rules do not, however, permit a definitive view as to whether Prudential (or Jackson) would or would not be designated as systemically important.

Other changes in the Dodd Frank Act include the creation of a new 'Federal Insurance Office' within the Treasury Department that will, amongst other things, monitor (but not regulate) the insurance industry and, conduct a study of how to improve insurance regulation in the United States; discretionary authority for the SEC to impose a harmonised standard of care for investment advisers and broker dealers which provide personalised advice about securities to retail customers; and requiring that certain derivatives be traded on registered exchanges and cleared through registered central counterparties.

Prudential and Jackson have determined that they are not swap dealers/security-based swap dealers or major swap participants/major security-based swap participants. However, it is not yet clear how and to what extent other swaps regulation might apply to non-US institutions. With the passage of the Dodd Frank Act, certain derivatives instruments, including, but not limited to, futures contracts, interest rate swaps, and credit default swaps, may be required to trade on an exchange. While the transition to exchange-traded derivative instruments may limit counterparty risk, it could increase costs associated with such investments, including transaction and exchange fees. The standardization of exchange-traded derivative instruments may also limit the ability of Jackson and the mutual funds to customise certain derivative instruments with the counterparties. Exchange-trade derivative instruments may also require the Jackson and the mutual funds to post additional collateral or limit the types of collateral that may be used for such transactions, and this may limit the ability of the Jackson and the mutual funds to effectively deploy assets in a timely manner.

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The timing and the ultimate impact on the management and operations of Prudential and the regulations promulgated, or to be promulgated, pursuant to these statutory provisions, cannot yet be definitively determined.

Proposals to change the laws and regulations governing the financial services industry are frequently introduced in the US Congress, in the state legislatures and before the various regulatory agencies. The likelihood and timing of any proposals or legislation, and the impact they might have on Jackson, its subsidiaries, or other Prudential subsidiaries doing business in the US, cannot be determined at this time.

State legislatures and/or state insurance regulatory authorities frequently enact laws and/or regulations that significantly affect insurers supervised by such authorities. Although the US federal government does not directly regulate the insurance business, federal initiatives may also have an impact on the insurance industry.

A coalition of national insurance and banking organisations has supported the introduction of US federal legislation that would allow insurance companies to obtain a federal charter as a regulatory alternative to a state charter. A coalition of insurers has been formed that is opposed to the so-called optional federal charter. Prudential cannot predict whether any federal charter or any other federal (or state) legislative initiative to change the nature or scope of the regulation of the insurance industry will be enacted into law.

Federal and state regulators have focused on the mutual fund and variable annuity and insurance product industries including the broker-dealer system. As a result of publicity relating to widespread perceptions of industry abuses, including fraudulent and anti-competitive practices among insurance brokers and mutual funds, there have been numerous regulatory inquiries and proposals for legislative and regulatory actions that could affect the operations and management of market participants. It is difficult to predict at this time whether changes resulting from industry investigations and/or new laws and regulations will affect the Group's insurance or investment management businesses, and, if so, to what degree.

Capital Expenditures and Divestures

Please refer to Item 5 'Operating and Financial Review' Liquidity and Capital Resources Changes to Group holdings during the period' for a discussion of the principal capital expenditures and divestures during the period under review.

Item 4A. Unresolved Staff Comments

None

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Item 5. 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 in this document.

A summary of the critical accounting policies which have been applied to these statements is set forth in the section below entitled 'IFRS 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 ' Principal Factors Affecting Results of Operations' and in Item 3, 'Key Information Risk Factors' and elsewhere in this document.

Introduction and Overview

Prudential is an international retail financial services group with significant operations in Asia, the US and the UK. Prudential serves around 24 million insurance customers globally and has £405 billion of assets under management. Prudential is listed on stock exchanges in London, Hong Kong, Singapore and New York. Prudential is structured around four main business units: Prudential Corporation Asia, (incorporating the asset management business, Eastspring Investments), Jackson, Prudential UK and M&G.

Prudential is a leading life insurer in Asia operating in 13 markets (including Cambodia, where operations were launched in 2013). Prudential has built a high performing platform with effective, multi-channel distribution, a product portfolio centred on regular savings and protection, award winning customer services and a well respected brand. Prudential's Asian based asset management division, Eastspring Investments, is one of the region's leading fund managers and the largest retail asset manager.

Jackson is one of the largest life insurance companies in the US, providing retirement savings and income solutions to approximately 4 million customers. Jackson is also one of the top two providers of variable annuities in the US. Founded 50 years ago, Jackson has a long and successful record of providing advisers with the products, tools and support to design effective retirement solutions for their clients.

Prudential UK is a leading life and pensions provider to approximately 7 million customers in the United Kingdom. Prudential believes that its expertise in areas such as longevity, risk management and multi-asset investment, together with its financial strength and highly respected brand, means that the business is strongly positioned to continue pursuing a value-driven strategy built around our core strengths in with-profits and annuities.

M&G is Prudential's UK and European fund management business with total company and external assets under management of £228 billion (at 31 December 2012). M&G has been investing money for individual and institutional clients for over 80 years. It is one of Europe's largest active investment managers.

Summary of Performance

The Group reported a strong performance in 2012. Our focus on our customers in each of our geographies combined with the strength of our distribution, franchise and brands, has allowed us to continue to provide distinctive value to our customers. Thanks to this, the Group has continued to deliver on the three key financial metrics we have focused on since 2009: IFRS operating profit, new

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business profit and net cash remittances. In 2012 in Asia, we have achieved two of the 2013 'Growth and Cash' objectives and have continued to make progress towards achieving the others, despite a global macroeconomic environment which remains challenging and historically low long-term interest rates.

Prudential Corporation Asia (insurance operations)

Asia has delivered excellent results in 2012. Our business, Prudential Corporation Asia, which is already one of the largest in the region, has nevertheless been able to more than double its IFRS operating profit based on longer-term investment returns in three years to almost £1 billion, delivering £988 million in 2012. That growth in IFRS operating profit based on longer-term investment returns was not achieved at the expense of cash generation or by slowing down sales growth. It also delivered a net cash remittance of £341 million, exceeding its 2013 objective of £300 million. For the first time in our history, Asia was the largest contributor of cash to the Group, an exceptional performance when you consider that in 2009 Asia's net cash remittance was £40 million. This performance was largely driven by the clear progress we have made in some of our 'sweet-spot' markets particularly Indonesia, Singapore, Malaysia, the Philippines and Thailand.

Our strategy in Asia is focused on meeting the needs of the emerging middle class in the region for savings and protection. The region's positive demographics, strong economic growth, sound public finances and favourable public policy environment with a clear preference for private provision of protection, have all led to a rapidly expanding middle class, with a strong and growing demand for our savings and protection products.

Geographically, Asia is a vast and diverse region. Our primary area of focus is on what we call our 'sweet-spot' Indonesia, Hong Kong, Singapore, Malaysia, the Philippines, Thailand and Vietnam all these markets have attractive long term characteristics. We are in a strong position to capture profitably the growing demand for our products and services in these selected markets. We continuously invest in these markets to grow our distribution and to ensure we are well positioned in terms of people, systems and capabilities. We will continue to innovate to meet the evolving needs of our customers and maintain our focus on regular premium savings and protection products.

We have delivered healthy and sustainable quality growth in Asia. While under-penetration of insurance in markets across the region offers significant long-term growth opportunities, we retain our focus on value not volume. We refocused our businesses in Taiwan, Korea and Malaysia, deliberately reducing sales of lower margin products to ensure a consistent focus on higher value lines.

Our life business in Asia, with its focus on capital-efficient products and fast payback periods, continues to deliver profitable, cash generative growth. IFRS long-term operating profit based on longer-term investment returns in Asia increased by 30 per cent in the period to £920 million (2011: £709 million)[11] and net cash remittances increased by 66 per cent to £341 million (2011: £206 million).

Our four largest markets Indonesia, Hong Kong, Singapore and Malaysia have made the most material contribution to the region's growth in recent years. In addition to our well known strength in these four markets, we are building our presence and distribution in other markets that have the potential to become material drivers of growth over the medium and long term. Two such markets are Thailand and the Philippines. In Thailand, a market with considerable and attractive growth potential, where we were historically underweight, our recently announced exclusive long-term bancassurance partnership with Thanachart, and the acquisition of Thanachart Life, fulfils our longstanding ambition to significantly increase our footprint in that country. In the Philippines, where we are a market leader, our business is now making good progress delivering strong and profitable growth. We believe this market has promising prospects due to its large population and the improved quality of its macroeconomic

(11) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 to the Prudential's consolidated financial statements in Item 18.

management, with its renewed emphasis on attracting foreign direct investment as well as the upgrading of the country's infrastructure. In January 2013, we started life insurance operations in Cambodia, our thirteenth market and entered into a partnership with ACLEDA Bank PLC, the largest retail and commercial bank in the country. This is the first deal of its kind in Cambodia, where we believe there are significant opportunities for growth as the market develops.

Overall, our geographic footprint, combined with the exceptional quality of our distribution and of our products, has enabled us to deliver another year of very strong performance in Asia. Our 13 million insurance customers, whom we serve well and profitably, represent only a small proportion of the long-term potential of this part of the world for our company.

Jackson

There was strong growth in the US, with total IFRS operating profit based on longer-term investment returns exceeding £1 billion for the first time, demonstrating the strength of Jackson's operations in a competitive marketplace. The US is the world's largest retirement savings market, with large cohorts of the 78 million baby-boomers(12) reaching retirement age each year, creating significant demand for retirement income products. Our strategy in the US is to take advantage of this profitable growth opportunity. We approach this with a long-term perspective, proactively managing sales through the economic cycle as our experience has shown us how important it is to put value ahead of volume in the variable annuity market. We take at all times a conservative approach to pricing, even when that means losing market share to other players, while hedging our financial risks and managing our balance sheet.

In 2012, Jackson delivered IFRS long-term operating profit based on longer-term investment returns of £964 million, up 48 per cent on the prior year (2011: £651 million(13)). This increase in profits is in part due to increased fee income from the significant net flows captured in the last few years, and in part due to the non-recurring in 2012 of an accelerated deferred acquisition cost amortisation charge of £190 million in 2011.

There is always a degree of tactical management in the variable annuity market as sales are impacted by a number of factors, including but not limited to, equity market levels, interest rates and the actions of Jackson's competitors. During the second half of 2012, as equity markets recovered, we saw stronger sales growth in variable annuities despite pricing actions taken earlier in the year to mitigate the impact of lower investment returns as bond yields remained low. Therefore, in November and December, Jackson worked closely with distributors to proactively manage volumes and to ensure that the level of sales for 2012 would remain within the Group's quantitative risk appetite. We will continue to proactively balance value, volume, capital and balance sheet strength in this market.

In March 2012 we launched Elite Access, a variable annuity without guarantees, which offers access to alternative investments. It taps into an unmet demand from customers and has been particularly well received by distributors. The launch of Elite Access helps Jackson to continue growing within the Group's risk appetite for products with guarantees. The acquisition of REALIC, a traditional US life business, has helped to diversify Jackson's earnings and make the business more resilient.

In the context of industry debates about the advantages and disadvantages of various accounting methods, we believe that cash generation is ultimately a very tangible metric of the quality and value of a strategy. Therefore we set Jackson a net cash remittance objective for 2013 (as described further below) which, following the acquisition of REALIC, was increased from £200 million to £260 million. In

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(12) Source: US Census Bureau.

(13) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 to the Prudential's consolidated financial statements in Item 18.

2012, Jackson delivered net cash remittances of £249 million in the year (2011: £322 million including an exceptional release of surplus) and is on track to meet this objective.

Prudential UK & Europe (insurance operations)

The UK remains focused on with-profits products and individual annuities, seeing strong sales of both in a difficult market. In the UK, Prudential has adopted a focused strategy and competes selectively to help Britain's ageing population convert their accumulated wealth into retirement income. We have a clear focus on writing profitable new business while generating cash sustainably and preserving our capital. We concentrate on areas in which we have a clear competitive advantage, namely individual annuities and with-profits products, where we continue to be market leaders.

Over the last decade, Prudential has been widely recognised as the UK's leading with-profits manager. Our long-term approach to the management of the with-profits fund has continued to benefit customers during 2012 as it helps to provide protection from the full impact of volatile market conditions. The fund has consistently out performed the FTSE All-Share Index. Over the last 15 years, the fund has delivered a cumulative investment return of 184.3 per cent on investments covering policyholder liabilities. This compares favourably with the FTSE All-Share Index total return of 106.5 per cent over the same period. Total bonus payments are expected to top £2 billion in 2013 and our policyholders will typically see year-on-year increases of between 3.5 per cent and 6.5 per cent in accumulating with-profits policy values. Since 2003 an estimated £22 billion has been added to policy values. Our UK business is also one of the largest providers of annuities in the UK and in 2012 paid out £2.9 billion in income to UK annuitants.

Our performance in 2012 has been strong in a difficult market, which has been impacted by significant UK and EU regulatory change. This includes the implementation of the Retail Distribution Review (RDR), auto-enrolment for company pension schemes and Gender Neutral Pricing.

Our UK business has demonstrated resilience as it continues to benefit from its focus on its core products, with-profits and individual annuities, with increased sales for both. Where we see opportunities for future profitable growth we will seek to capitalise on them but only if they meet our payback criteria. In 2013 we have commenced sales operations in Poland, one of Europe's fastest-growing economies, which has an expanding middle class and high savings rates.

We continue to assess the impact of the RDR, which was implemented on 31 December 2012 and the resulting changes to distributors' business models. This is likely to lead to some short-term dislocation in the market as consumers and distributors adjust to the new sales environment. We expect this transition phase to dampen our sales of investment bonds in 2013, compared to the high sales in 2012. We are confident that the strength of our brand combined with our investment capabilities, financial strength and experience will ensure that we remain well placed to provide customers with dependable retirement income. We believe that with-profits products will continue to be popular with customers seeking competitive long-term real investment returns.

Net cash remittances were £313 million, up 5 per cent (2011: £297 million). Our inherited estate, which is estimated at £7.0 billion (31 December 2011: £6.1 billion), is a key source of capital strength.

Asset Management

Our asset management business, M&G has seen record net flows, at £16.9 billion, IFRS operating profit and funds under management, all driven by its investment performance and customer proposition.

M&G, has continued to focus on delivering superior investment performance for our customers while maximising the strength of its distribution capabilities. It has pursued business diversification across both geographies and asset classes. Its retail funds are now registered for sale in 20 jurisdictions, with offices in 15 countries. During 2012, the business has seen record net sales, funds under

management and IFRS operating profit. The growth in sales has been driven by M&G's business in Continental Europe as investor risk appetite returned.

M&G continued to attract significant new asset flows during the recent years of global market volatility, testament to the strength of its reputation and focus on investment performance. It has seen record total retail and institutional net inflows of £16.9 billion in 2012, significantly higher than 2011 and the previous high of £13.5 billion in 2009.

Total net sales in the UK were lower than 2011, reflecting the maturity of the UK business and management decisions to slow the inflow of new money into two market-leading UK corporate bond funds to safeguard investment performance. We expect these trends to persist in 2013. Despite the deliberate slowing of sales in the UK, M&G was the UK's top-selling investment management house in 2012 and has ranked number one for both net and gross fund sales for an unprecedented four consecutive calendar years. Net fund sales in Continental Europe have increased, generating a record £5.2 billion of net sales in 2012. Assets sourced from outside the UK account for 29 per cent of total retail funds under management, up from 25 per cent in 2011.

Underlying profits for the full year rose by 14 per cent to a new record level of £298 million. Following the addition of performance-related fees and profit from our associate investment in South Africa, total operating profit based on longer-term investment returns for 2012 was £320 million. M&G's funds under management also grew to a record £228 billion (2011: £201 billion).

Looking ahead, the diversification of our business by asset class and geography positions us well to manage the expected shifts in consumer asset allocation going forward.

Eastspring Investments, our rebranded Asia asset management business, increased funds under management to £58.1 billion, up 16 per cent (2011: £50.3 billion). IFRS operating profit based on longer-term investment returns was marginally lower, reflecting a change in product mix towards bond funds that attract lower fees. Also costs were higher as we continued to invest in people and infrastructure, as we build out our offshore capabilities following the launch of the new brand. This included opening a US distribution office, starting an operation in Indonesia and launching new funds in Taiwan, China and India.

2013 'Growth and Cash' Financial Objectives

As with other aspects of this annual report the following discussion contains forward-looking statements that involve inherent risks and uncertainties. Prudential's actual future financial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement due to a number of important factors (including those discussed under Item 3 'Risk factors' in this filing). See the discussion under the heading 'Forward-looking statements' in Item 3. The objectives assume current exchange rates and a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the full year 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II (as described in the Risk and Capital Management section of this filing), which remains uncertain.

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

(i) Asia growth and profitability objectives:

To double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: £465 million); and

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To double the 2009 value of new business profits[14] in 2013 (2009: £713 million).

(ii) Business unit cash remittance objectives:

Asia to deliver £300 million of net cash remittance to the Group in 2013 (2009: £40 million);

Jackson to deliver £260 million[15] of net cash remittance to the Group in 2013 (2009: £39 million); and

UK to deliver £350 million of net cash remittance to the Group in 2013 (2009: £284 million[16]).

(iii) Cumulative net cash remittances:

All business units in aggregate to deliver cumulative net cash remittances of at least £3.8 billion over the period 2010 to end-2013. These net remittances are to be underpinned by a targeted level of cumulative underlying free surplus[17] generation of £6.5 billion over the same period.

The Group remains focused on these objectives and has continued to make progress towards them. Prudential has delivered its IFRS operating profit and net remittance objectives for Asia one year early and is on track to achieve those that remain outstanding.

Summary of Capital and Risk Management

We take a disciplined approach to capital management and continue to take action to ensure our capital works efficiently and effectively for the Group. Using the regulatory measure of the Insurance Groups Directive, our Group capital surplus position at 31 December 2012 was estimated at £5.1 billion (31 December 2011: £4.0 billion), before allowing for the final dividend. The Group's required capital cover was 3 times. The structure of the Group and the approach we have taken to managing our risks, with a sizeable credit reserve in the UK annuity book, a strong inherited estate in UK with-profits and the relatively low risk nature of our asset management and Asian operations, together with a high level of IGD surplus means we have positioned ourselves well for future regulatory developments and stresses to our business.

There is broad agreement that ultimately it would be beneficial to replace the IGD regime with a regime that is more risk based. Solvency II may provide such a framework but we now know that it will not be implemented before 31 December 2015. In common with other insurers we have been working with regulators to ensure that the current capital regime remains robust while we wait for the implementation of Solvency II.

In early March 2013, we agreed with the FSA to revise the calculation of the contribution Jackson makes to the Group's IGD surplus. We consider the revised basis to be an improvement as it is more closely aligned to the one we use to assess and report free surplus. In the absence of an agreed Solvency II approach, we believe that this change makes the IGD surplus a more meaningful measure and one that is more closely aligned with economic reality. The revised IGD surplus calculation has no impact on the way that the US business is managed or regulated locally. On this revised basis, the IGD

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(14) New business profits are the profits, calculated in accordance with EEV Principles (as defined further under the section "EEV Basis and New Business Results" in Item 3), from business sold in the financial reporting period under consideration.

(15) The net remittance objective for Jackson was increased from £200 million to £260 million to reflect the positive impact of the acquisition of REALIC.

(16)

Representing the underlying remittances excluding the £150 million impact of proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

(17)

Group free surplus at the end of the period comprises free surplus for the insurance businesses, representing the excess of the net worth over the required capital included in the EEV results, and IFRS net assets for the asset management businesses excluding goodwill. The free surplus generated during the period comprises the movement in this balance excluding foreign exchange, capital movements, and other reserve movements. Specifically, it includes amounts maturing from the in-force operations during the period less the investment in new business, the effect of market movements and other one-off items.

surplus at 28 February 2013 is estimated at £4.4 billion[18], before allowing for the final dividend, equivalent to a capital cover of 2.5 times.

Uncertainty about the final Solvency II outcome remains. We will continue to evaluate our options, including consideration of the Group's domicile, in the event that the final outcome is negative and potentially impacts our ability to deliver value to our customers and shareholders. We welcome the decision by the UK Financial Services Authority to strengthen the existing Individual Capital Adequacy Standards (ICAS) regime in the absence of the implementation of Solvency II.

Outlook

In 2012, Prudential delivered a strong performance. In spite of tough macroeconomic conditions and the negative effect of persistently low long-term interest rates, the Group has achieved significant and profitable growth and produced increased levels of cash, which allowed the Group to provide their shareholders with a growing dividend.

Prudential's strategy and operating principles remain clear and unchanged. Asia is the key driver of sustainable and profitable growth, building on the significant opportunity that the emergence of the growing and increasingly wealthy middle class in this region represents. The Group's best opportunities lie in South-east Asia, where the depth and breadth of Prudential's franchise is a source of strength. Prudential's business units in the US and in the UK will continue to focus on delivering strong earnings and cash. The Group will achieve this by continuing to execute with discipline, by maintaining a robust balance sheet and with proactive risk management.

Prudential is set to continue to provide a distinctive combination of profitable growth and cash by meeting the needs of their customers across the world. The Group's confidence is reflected in the decision to rebase the dividend upwards, the second time in three years, as they remain focused on creating long-term, sustainable value for their shareholders.

Principal factors affecting Prudential's 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 regulation and exchange rate fluctuations, as discussed in greater detail below. In addition, changes in interest rates and returns from equity, real estate and other investments as well as volatility in these items may affect Prudential's profitability.

Please refer to "Introduction and Overview", Item 3. "Key Information Risk Factors" and Item 4. "Information on the Company Business of Prudential" for additional discussion of factors that may impact Prudential's results of operations.

General economic and market conditions

Prudential's results of operations are impacted by general economic and market conditions and are sensitive to the pace of and extent of changes in equity markets and interest rates, as well as the changes in behaviour of individuals and institutions that these changes in economic and market

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(18) The estimated position at 28 February 2013 allows for economic conditions and surplus generation since 31 December 2012 and is stated before the final dividend and the effect of the Thanachart acquisition and after allowing for a reduction in Jackson's contribution to IGD surplus of £1.3 billion.

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conditions may cause. Particular features of relevance to the Prudential's geographic areas of operations are shown below:

Asia

Asia's rapidly growing middle classes remain a key growth driver for the retail financial services sector, particularly life insurance with an emphasis on protection. Research has shown that as the middle class becomes more established the proportion of income they allocate to financial planning increases from 5 per cent to around 15 per cent . The manifestation of this demand varies significantly across the region, reflecting the various stages of development in each individual market, together with their distinct regulatory and competitive environments, cultural differences and customer preferences. However, across all markets there is increasing recognition among governments and regulators of the social utility of a vibrant private sector life insurance market that provides financial security to families, efficiently channels long-term savings into financial markets and generates employment opportunities within the industry.

During 2012 Asia's average economic growth rates, although they remained well above the global average, continued to moderate following the post crisis high seen in 2010. This is to some degree a consequence of the ongoing weakness of the economies of North America and Europe. While domestic factors were a significant influence in India and China as policymakers grapple with sensitive political situations and economic imbalances, the resilience of many other economies in the region, particularly in South-east Asia, was highlighted by upward revisions to IMF growth forecasts in the second half of the year. Hong Kong's economic growth accelerated during the fourth quarter last year and looks set to have an improved year in 2013 and Singapore has said that the outlook for its economy is cautiously positive as it also had a better than expected fourth quarter. However, the strongest performing regional economies were led by Indonesia, Malaysia, the Philippines and Thailand where growth is increasingly driven by the expansion of domestic demand and is less reliant on exports.

United States

The United States is the world's largest retirement savings market. Each year, many of the 78 million 'baby boomers' reach retirement age, which will trigger a shift from savings accumulation to retirement income generation for more than US$10 trillion of accumulated wealth over the next decade[19]. This demographic transition provides a significant opportunity for those companies that are able to provide long-term retirement solutions. Jackson takes a selective approach to this opportunity by leveraging its distribution capabilities and asset liability management expertise to offer prudently priced annuity products.

Despite the ongoing challenges faced by the global economy, US equity markets delivered strong gains in 2012. The S&P 500 index increased by 13.4 per cent over the course of the year and market volatility declined notably from the levels experienced in 2011. Interest rates remained historically low with the 10-year treasury rate ending below 180 bps at year end, while corporate spreads tightened considerably from 2011 year end levels.

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

Jackson's strategy remains focused on driving shareholder value while operating within a conservative risk management framework. This approach has enabled Jackson to successfully navigate

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(19) Source: US Census Bureau.

the significant macroeconomic and financial market challenges of the last five years and ensured a continuation of the strong performance in 2012.

Jackson was predominantly a spread-based business until recently, with the majority of its assets invested in fixed income securities. Recently its fee-based business has become more prominent and now represents a significant part of Jackson's business mix.

Spread-based products written by Jackson are principally for fixed interest rate annuities. Sales of life business, including interest sensitive life products, were discontinued in the second half of 2012. Jackson also writes fixed index annuities and institutional business that are spread-based products. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the contract holder liabilities and the amounts that are credited to contract holders in the form of benefit increases, subject to minimum crediting rates.

In general, Jackson's results are significantly affected by fluctuations in economic and market conditions, especially interest rates, credit conditions and equity markets. The profitability of Jackson's spread-based business depends in large part on its ability to manage interest rate exposure, as well as the credit and other risks inherent in its investment portfolio. Jackson designs its US products and manages the investments and liabilities to reduce overall interest rate sensitivity. This has the effect of moderating the impact on Prudential's results of changes in prevailing interest rates.

Jackson's exposure to interest rate risk relates primarily to the market price and cash flow variability associated with changes in interest rates. Changes in interest rates, either upward or downward, including changes in the difference between the levels of prevailing short-term and long-term rates, can expose Jackson to the risk of not earning anticipated spreads. For example, if interest rates increase and/or competitors offer higher crediting rates, withdrawals on annuity contracts may increase as contract holders seek higher investment returns elsewhere. In response, Jackson could (i) raise its crediting rates to stem withdrawals, decreasing its spread; (ii) sell assets which may have depressed values in a high interest rate environment to fund policyholder payments, creating realised investment losses; or (iii) pay out from existing cash which would otherwise have been invested and earned interest at the higher interest rates.

Conversely, if interest rates decrease, withdrawals from annuity contracts may decrease relative to original expectations, creating more cash than expected to be invested at lower rates. Jackson may have the ability to lower the rates it credits to contract holders as a result, but may be forced to maintain crediting rates for competitive reasons or because there are minimum interest rate guarantees in certain contracts. In either case, the spread earned by Jackson would be compressed.

The majority of assets backing the spread-based business are invested in fixed income securities. Jackson actively manages its investment and derivative portfolio, considering a variety of factors, including the relationship between the expected duration of its assets and its liabilities.

Recent periods have been characterised by low interest rates. The current low interest rate environment is likely to be prolonged. A prolonged low interest rate environment may result in a lengthening of maturities of the contract holder liabilities from initial estimates, primarily due to lower policy lapses. As interest rates remain at low levels, Jackson may also have to reinvest the cash it receives as interest or proceeds from investments that have matured or that have been sold at lower yields, reducing its investment margins. Moreover, borrowers may prepay or redeem the securities in its investment portfolio with greater frequency in order to borrow at lower market rates, which exacerbates this risk.

The majority of Jackson's fixed interest rate annuities and life products were designed with contractual provisions that allow crediting rates to be re-set annually subject to minimum crediting rate guarantees. Therefore, on new business written, as well as on in-force business above minimum guarantees, Jackson has adjusted, and will continue to adjust, crediting rates in order to maintain

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targeted interest rate spreads. Lowering crediting rates helps to mitigate the effect of spread compression but the spreads could still decline as Jackson is typically only entitled to reset the crediting rates at limited pre-established intervals and the re-setting is subject to the guaranteed minimum rates. As at 31 December 2012, approximately 87 per cent of Jackson's fixed interest rate annuities and interest-sensitive life business account values correspond to crediting rates that are at the minimum guaranteed interest rates (2011: 84 per cent). Tabular disclosures are provided in Item 4. 'Information on the Company Business of Prudential US Business Products' and note D3(d) to the consolidated financial statements in Item 18 on the distribution of the account values of these businesses within the range of their contractual minimum guaranteed interest rates. The tables demonstrate that approximately 70 per cent (2011: 78 per cent) of Jackson's combined fixed interest rate annuities and interest sensitive life business account values of £20 billion (US$33 billion (2011: £20 billion (US$31billion)) have contractual minimum rates of 3 per cent or less.

Jackson's expectation for future spreads is also an important component in the amortisation of deferred acquisition costs. Significantly lower spreads may cause it to accelerate amortisation, thereby reducing total IFRS profit in the affected reporting period. Low market interest rates could also reduce Jackson's return on investments that are held to support the company's capital. In addition, changes in interest rates will affect the net unrealised gain or loss position of Jackson's available-for-sale fixed income securities which is reported as a component of other comprehensive income. Further information on the factors affecting the pricing of products and asset liability management of Jackson is provided in Item 4. 'Information on the Company Business of Prudential US Business'.

In addition to the impact on Jackson's spread product profitability, a prolonged period during which interest rates remain at levels lower than those anticipated in its pricing may also result in greater costs associated with certain of Jackson's product features which guarantee benefits and higher costs for derivative instruments used to hedge certain of its product risks. Reflecting these impacts in recoverability and loss recognition testing under U.S. GAAP as 'grandfathered' under IFRS may require Jackson to accelerate the amortisation of DAC as noted above, as well as to increase required reserves for future contract holder benefits. In addition, certain statutory capital and reserve requirements are based on formulas or models that consider interest rates, and a prolonged period of low interest rates may increase the statutory capital Jackson is required to hold as well as the amount of assets it must maintain to support statutory reserves.

Accordingly, without active management, a prolonged low interest rate environment may materially affect Jackson's financial position, results of operations and cash flows. However, Jackson has and continues to proactively adapt its asset-liability management, hedging programme, product design and pricing and crediting rate strategies to mitigate the downward pressures created by the prolonged low interest rate environment.

The sensitivity of Jackson's IFRS basis profit or loss and shareholders' equity to changes in interest rates is provided in note D3(h) to the consolidated financial statements in Item 18.

The profitability of Jackson's fee-based business depends in large part on its ability to manage equity market risk. As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of guarantees. In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business to manage Jackson's equity exposure in a cost-effective fashion. Jackson believes that the internal management of equity risk coupled with the utilisation of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure. Profits in the variable annuity book of business will continue to be subject to the impact of market movements both on sales and allocations to the variable accounts and the effects of the economic hedging program. While Jackson hedges its risk on an economic basis, the nature and

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duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility.

Jackson continues to believe that, on a long-term economic basis, its equity exposure remains well managed.

United Kingdom

The life and pensions market in the UK is mature and highly regulated. Significant regulatory change occurred in 2012 with the implementation of the conclusions of the Retail Distribution Review (RDR), auto-enrolment for company pension schemes and Gender Neutral Pricing. These new regulations represent major changes to the way business is conducted in a number of areas of the markets in which we operate in the UK, and impact not only insurance and investments providers, but also distributors and consumers. It is inevitable that regulatory change of this scale and scope creates a period of uncertainty before the shape of the new long-term competitive landscape becomes evident.

The UK market is also characterised by an ageing population and a concentration of wealth in the 50+ age group, many of whom have built up substantial pension funds in employer-sponsored schemes. These customers require help to convert their wealth into sustainable lifetime income. For the next generation of savers, the responsibility for retirement provision has shifted substantially away from Government and employers towards the individual. These customers are typically under-funded for retirement and helping them accumulate saving constitutes a significant opportunity for long-term savings and retirement income providers, at a time when the ability of the state to intervene is significantly diminished.

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

In the United Kingdom, where Prudential's with-profits fund invests in debt and other fixed income securities, equity securities and real estate, shareholders' profits under IFRS are strongly related to the bonuses it declares. The most important influences on the bonus rates are the overall rate of return earned on investments and Prudential's expectation of future investment returns. Further information on with-profits products is provided in Item 5 'Basis of Profits', ' With-Profits Products' and ' Bonus Rates' below. In addition, shareholders' profits under IFRS are significantly influenced by the contribution from the growing shareholder backed annuity business. The key factors affecting the profitability of this business are described in note D2 to the consolidated financial statements in Item 18.

Government policy and regulation

Changes in government policy or regulation applying to companies in the financial services and insurance industries in any of the jurisdictions in which Prudential operates, particularly in Asia, the United Kingdom and the United States, may adversely affect the result of its operations. These include possible changes in the tax treatment of financial products and services, government pension arrangements and policies, the regulation of selling practices and solvency standards.

These changes may affect 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.

In recent years, the insurance sectors in the markets in which Prudential operates have seen considerable regulatory change. In Asia, more generally as the life insurance industry continues to grow, so the regulatory environment continues to evolve. Regulators are encouraging insurers to strengthen their risk and solvency management processes and to improve their sales processes to ensure that

customers receive good quality advice and buy products suitable to their needs. Most international insurers operating in the region are supportive of these trends and generally aim to operate above current local regulatory standards. The recent recommendations of the Monetary Authority of Singapore's FAIR Panel are indicative of the kind of regulatory efforts under way in the region to improve the overall standard of agency distribution in insurance. In the UK, significant regulatory change occurred in 2012 with the implementation of the conclusions of the Retail Distribution Review (RDR), auto-enrolment for company pension schemes and Gender Neutral Pricing as described above. Further details on the regulatory supervision which Prudential is subject to in the UK and internationally are provided in Item 4 'Information on the Company Supervision and Regulation'.

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 Asia, the United States and Europe, which represent a significant proportion of total group income and expenses, generally write policies and invest in the same local currency, which although limiting the effect of exchange rate fluctuations on local operating results, can lead to fluctuations in Prudential's consolidated financial information upon translation of results into pounds sterling. Please refer to Item 4 'Information on the Company Business of Prudential Group Risk Framework Financial Risks Foreign Exchange Risk' and notes D2, D3 and D4 for additional information on the impact of foreign currency fluctuations on the Group.

IFRS 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 IFRS as issued by the IASB and as endorsed by the EU. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2012, there were no unendorsed standards effective for the three years ended 31 December 2012 affecting the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the three years ended 31 December 2012 is prepared in accordance with IFRS as issued by the IASB. Prudential adopts mandatory requirements of new or altered EU-adopted IFRS standards when required, and may consider earlier adoption where permitted and appropriate in the circumstances.

The preparation of these financial statements requires Prudential to make estimates and judgements that affect the reported amounts of assets, liabilities, and revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Prudential evaluates its estimates, including those related to long-term business provisioning and the fair value of assets.

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially give rise to different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to those described below.

The critical accounting policies in respect of the items discussed below are critical for those that relate to the Group's shareholder-financed business. In particular this applies for Jackson which is the largest shareholder-backed business in the Group. The policies are not critical in respect of the Group's with-profits business. This distinction reflects the basis of recognition of profit and accounting treatment of unallocated surplus of with-profits funds as a liability, as described elsewhere in these financial statements.

In determining the measurement of the Group's assets and liabilities estimates and judgements are required.

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The critical aspects are described below.

Investments

Determining the fair value of financial investments when the markets are not active

The Group holds certain financial investments for which the markets are not active. These can include financial investments which are not quoted on active markets and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. When the markets are not active, there is generally no or limited observable market data to account for financial investments at fair value. The determination of whether an active market exists for a financial investment requires management's judgement.

If the market for a financial investment of the Group is not active, the fair value is determined by using valuation techniques. The Group establishes fair value for these financial investments by using quotations from independent third-parties, such as brokers or pricing services or by using internally developed pricing models. Priority is given to publicly available prices from independent sources when available, but overall the source of pricing and/or the valuation technique is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The valuation techniques include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation and may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these financial investments.

The financial investments measured at fair value are classified into the following three level hierarchy on the basis of the lowest level of inputs that is significant to the fair value measurement of the financial investment concerned:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2: Inputs other than quoted prices included within level 1 that are observable either directly or indirectly (i.e. derived from prices).

Level 3: Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs).

At 31 December 2012, £6,660 million (2011: £4,565 million) of the financial investments (net of derivative liabilities) valued at fair value were classified as level 3. Of these £861 million (2011: £800 million) are held to back shareholder non-linked business and so changes to these valuations will directly impact shareholders' equity. Further details of the level 3 investments and the classification of financial instruments are given in note G1 to the consolidated financial statements in Item 18.

Determining impairments relating to financial assets

i Available-for-sale securities

The majority of Jackson's debt securities portfolio are accounted for on available-for-sale basis. The consideration of evidence of impairment requires management's judgement. In making this determination the factors considered include, for example:

- Whether the decline of the financial investment's fair value is substantial;

- A substantial decline in fair value might be indicative of a credit loss event that would lead to a measurable decrease in the estimated future cash flows;

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The impact of the duration of the security on the calculation of the revised estimated cash flows;

The duration of a security to maturity helps to inform whether assessments of estimated future cash flows that are higher than market value are reasonable;

The duration and extent to which the amortised cost exceeds fair value;
This factor provides an indication of how the contractual cash flows and effective interest rate of a financial asset compares with the implicit market estimate of cash flows and the risk attaching to a 'fair value' measurement. The length of time for which that level of difference has been in place may also provide further evidence as to whether the market assessment implies an impairment loss has arisen; and

The financial condition and prospects of the issuer or other observable conditions that indicate the investment may be impaired.
If a loss event that will have a detrimental effect on cash flows is identified an impairment loss in the income statement is recognised. The loss recognised is determined as the difference between the book cost and the fair value of the relevant impaired securities. This loss comprises the effect of the expected loss of contractual cash flows and any additional market-price-driven temporary reductions in values.

For Jackson's residential mortgage-backed and other asset-backed securities, all of which are classified as available-for-sale, the model used to analyse cash flows, begins with the current delinquency experience of the underlying collateral pool for the structure, by applying assumptions about how much of the currently delinquent loans will eventually default, and multiplying this by an assumed loss severity. Additional factors are applied to anticipate ageing effects. After applying a cash flow simulation an indication is obtained as to whether or not the security has suffered, or is anticipated to suffer, contractual principal or interest payment shortfalls. If a shortfall applies an impairment charge is recorded. The difference between the fair value and book cost for unimpaired securities designated as available-for-sale, is accounted for as unrealised gains or losses, with the movements in the accounting period being included in other comprehensive income.

The Group's review of fair value involves several criteria, including economic conditions, credit loss experience, other issuer-specific developments and future cash flows. These assessments are based on the best available information at the time. Factors such as market liquidity, the widening of bid/ask spreads and a change in cash flow assumptions can contribute to future price volatility. If actual experience differs negatively from the assumptions and other considerations used in the consolidated financial statements, unrealised losses currently in equity may be recognised in the income statement in future periods. Additional details on the impairments of the available-for-sale securities of Jackson are described in notes D3 and G5 to the consolidated financial statements in Item 18.

Impairment losses recognised on available-for-sale securities amounted to £37 million (2011: £62 million; 2010: £124 million). Of this amount, 22 per cent (2011: 34 per cent; 2010: 90 per cent) has been recorded on structured asset-backed securities, primarily due to reduced cash flow expectations on such securities that are collateralised by diversified pools of primarily below investment grade securities. Of the losses related to the impairment of fixed maturity securities, the top five individual corporate issuers made up 74 per cent (2011: 75 per cent; 2010: 32 per cent), reflecting a deteriorating business outlook of the companies concerned. The impairment losses have been recorded in 'investment return' in the income statement.

In 2012, the Group realised gross losses on sales of available-for-sale securities of £44 million (2011: £43 million; 2010: £160 million) with 64 per cent (2011: 64 per cent; 2010: 45 per cent) of these losses related to the disposal of fixed maturity securities of 10 (2011: 10; 2010: 15) individual issuers, which were disposed of as part of risk reduction programmes intended to limit future credit loss

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exposure. Of the £44 million (2011: £ 43 million; 2010: £160 million), £23 million (2011: £32 million; 2010: £99 million) relates to losses on sales of impaired and deteriorating securities.

The effect of those reasonably likely changes in the key assumptions that underpin the assessment of whether impairment has taken place depends on the factors described above. A key indicator of whether such impairment may arise in future, and the potential amounts at risk, is the profile of gross unrealised losses for fixed maturity securities accounted for on an available-for-sale basis by reference to the time periods by which the securities have been held continuously in an unrealised loss position and by reference to the maturity date of the securities concerned.

In 2012, there was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £2,057 million to a net unrealised gain of £2,807 million. The gross unrealised gain in the statement of financial position increased from £2,303 million at 31 December 2011 to £2,985 million at 31 December 2012 (31 December 2010: £1,580 million), while the gross unrealised loss decreased from £246 million at 31 December 2011 to £178 million at 31 December 2012 (31 December 2010: £370 million).

Available for sale securities

The following table shows the fair value of those securities that are in a gross unrealised loss position for various percentages of book value at 31 December:

	2012		2011	
	Fair value £m	Unrealised loss £m	Fair value £m	Unrealised loss £m
Between 90% and 100%	**4,214**	**(112)**	1,829	(60)
Between 80% and 90%	**85**	**(13)**	172	(28)
Below 80%*	**74**	**(53)**	208	(158)
Total	**4,373**	**(178)**	2,209	(246)

* The unrealised losses as at 31 December 2012 include £77 million (2011: £183 million) relating to mortgage-backed and other debt securities. The unrealised losses in the portfolio by reference to the length of time 3 years or more as at 31 December 2012 are £36 million (2011: £105 million) in the investment grade and £31 million (2011: £61 million) in non-investment grade.

ii Assets held at amortised cost

Except for certain loans of the UK insurance operations and Jackson National Life, which are accounted for on a fair value through profit and loss basis, and as described below, financial assets classified as loans and receivables under IAS 39 are carried at amortised cost using the effective interest rate method. The loans and receivables include loans collateralised by mortgages, deposits and loans to policyholders. In estimating future cash flows, the Group looks at the expected cash flows of the assets and applies historical loss experience of assets with similar credit risks that has been adjusted for conditions in the historical loss experience which no longer exist or for conditions that are expected to arise. The estimated future cash flows are discounted using the financial asset's original or variable effective interest rate and exclude credit losses that have not yet been incurred.

The risks inherent in reviewing the impairment of any investment include: the risk that market results may differ from expectations, facts and circumstances may change in the future and differ from estimates and assumptions, or the Group may later decide to sell the asset as a result of changed circumstances.

Certain mortgage loans of the UK insurance operations and, consequent upon the purchase of REALIC in 2012, policy loans held to back funds withheld under reinsurance arrangements have been

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designated at fair value through profit and loss as these loan portfolios are managed and evaluated on a fair value basis.

Insurance contracts

Product classification

IFRS 4 requires contracts written by insurers to be classified as either 'insurance contracts' or 'investment contracts' depending on the level of insurance risk transferred. Insurance risk is a pre-existing risk, other than financial risk, transferred from the contract holder to the contract issuer. If significant insurance risk is transferred by the contract then it is classified as an insurance contract. Contracts that transfer financial risk but not significant insurance risk are termed investment contracts. Furthermore, some contracts, both insurance and investment, contain discretionary participating features representing the contractual right to receive additional benefits as a supplement to guaranteed benefits:

a. that are likely to be a significant portion of the total contract benefits,

b. whose amount or timing is contractually at the discretion of the insurer, and

c. that are contractually based on asset or fund performance, as discussed in IFRS 4.

IFRS 4 permits the continued usage of previously applied GAAP for insurance contracts and investment contracts with discretionary participating features. Except for UK regulated with-profits funds, as described subsequently in section A4(b), this basis has been applied by the Group.

For investment contracts that do not contain discretionary participating features, IAS 39 and, where the contract includes an investment management element, IAS 18,'Revenue', apply measurement principles to assets and liabilities attaching to the contract.

Valuation assumptions

i Contracts of with-profits funds

For UK regulated with-profits funds, the contract liabilities are valued by reference to the UK Financial Services Authority's (FSA) realistic basis as described in section A4(b). This basis has the effect of placing a value on the liabilities of UK with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances. An explanation of the basis of liability measurement is contained in note D2(g)(ii) to the consolidated financial statements in Item 18.

The Group's other with-profits contracts are written in with-profits funds that operate in some of the Group's Asia subsidiaries. The liabilities for these contracts and those of Prudential Annuities Limited, which is a subsidiary company of the PAC with-profits fund, are determined differently. For these contracts the liabilities are estimated using actuarial methods based on assumptions relating to premiums, interest rates, investment returns, expenses, mortality and surrenders. The assumptions to which the estimation of these reserves is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders.

ii Other contracts

Contracts, other than those of with-profits funds, are written by shareholder-backed operations of the Group. The significant shareholder-backed product groupings and the factors that may significantly affect IFRS results due to experience against assumptions or changes of assumptions vary significantly between business units. For some types of business the effect of changes in assumptions may be significant, whilst for others, due to the nature of the product, assumption setting may be of less

significance. The nature of the products and the significance of assumptions are discussed in notes D2, D3 and D4 in the consolidated financial statements in Item 18.

UK insurance operations

From the perspective of shareholder results the key sensitivity for UK insurance operations are the assumptions for allowance for credit risk and mortality for UK annuity business.

Jackson

With the exception of institutional products and an incidental amount of business for annuity certain contracts, which are accounted for as investment contracts under IAS 39, all of Jackson's contracts are accounted for under IFRS 4 as insurance contracts by applying US GAAP, the previous GAAP used before IFRS adoption. The accounting requirements under these standards and the effect of changes in valuation assumptions are considered below for fixed annuity, variable annuity and traditional life insurance contracts.

Fixed annuity contracts, which are investment contracts under US GAAP terminology, are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts, namely deferred income, any amounts previously assessed against policyholders that are refundable on termination of the contract, and any premium deficiency, ie any probable future loss on the contract. These types of contracts contain considerable interest rate guarantee features. Notwithstanding the accompanying market risk exposure, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of Jackson's fixed annuity products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement.

Variable annuity contracts written by Jackson may provide for guaranteed minimum death, income, or withdrawal benefit features. In general terms, liabilities for these benefits are accounted for under US GAAP by using estimates of future benefits and fees under best estimate assumptions.

For traditional life insurance contracts, provisions for future policy benefits are determined using assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviation.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and the guaranteed minimum death benefit reserves, the profits of Jackson are relatively insensitive to changes in insurance risk. This reflects the principally spread and fee-based nature of Jackson's business.

Asia operations

The insurance products written in the Group's Asia operations principally cover with-profits business, unit-linked business, and other non-participating business. The results of with-profits business are relatively insensitive to changes in estimates and assumptions that affect the measurement of policyholder liabilities. As for the UK business, this feature arises because unallocated surplus is accounted for by the Group as a liability. The results of Asia unit-linked business are also relatively insensitive to changes in estimates or assumptions due to the matching of asset value and liability movements. For other Asia non-participating business the degree of sensitivity of results to changes in interest rates depends upon the degree to which the liabilities under the 'grandfathered' IFRS 4 measurement basis reflects market interest rates from period to period for example, for those countries, such as those applying US GAAP, the results can be more sensitive as the effect of interest rate

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movements on the backing investments may not be offset by liability movements due to the US GAAP basis of measurement of insurance contracts.

Deferred acquisition costs for insurance contracts

Except for acquisition costs of with-profits contracts of the UK regulated with-profits funds, which are accounted for under the realistic FSA regime to the consolidated financial statements in Item 18, costs of acquiring new insurance business are accounted for in a way that is consistent with the principles of the ABI SORP with deferral and amortisation against margins in future revenues on the related insurance policies. Costs of acquiring new insurance business, principally commissions, marketing and advertising and certain other costs associated with policy insurance and underwriting that are not reimbursed by policy charges, are specifically identified and capitalised as part of deferred acquisition costs (DAC). In general, this deferral is presentationally shown by an explicit carrying value for DAC in the balance sheet. However, in some Asia operations the deferral is implicit through the reserving methodology. The recoverability of the explicitly and implicitly deferred acquisition costs is measured and are deemed impaired if the projected margins are less than the carrying value. To the extent that the future margins differ from those anticipated, then an adjustment to the carrying value will be necessary.

For UK regulated with-profits funds where the realistic FSA regime is applied, the basis of setting liabilities is such that it would be inappropriate for acquisition costs to be deferred, therefore these costs are expensed as incurred. The majority of the UK shareholder-backed business is individual and group annuity business where the incidence of acquisition costs is negligible.

The deferral and amortisation of acquisition costs is of most relevance to the Group's results for Jackson and Asia operations. The DAC for Jackson and some Asia operations is determined with reference to US GAAP principles.

Jackson

Under IFRS 4, the Group applies grandfathered US GAAP for measuring the insurance assets and liabilities of Jackson. In the case of Jackson term business, acquisition costs are deferred and amortised in line with expected profits. For interest-sensitive business, the key assumption is the long-term spread between the earned rate on investments and the rate credited to policyholders, which is based on an annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all of which are based on a combination of Jackson's actual industry experience and future expectations. A detailed analysis of actual mortality, lapse and expenses experience is performed using internally developed experience studies.

For US variable annuity business the key assumption is the investment return from the separate accounts, which for 2012 and 2011 was 8.4 per cent per annum (after deduction of external fund management fees) determined using a mean reversion methodology. Under the mean reversion methodology, projected returns over the next five years are flexed (subject to capping) so that, combined with the actual rates of return for the current and the previous two years the 8.4 per cent rate is maintained. The projected rates of return are capped at no more than 15 per cent for each of the next five years Further details are explained in note D3(g) in the consolidated financial statements in Item 18. These returns affect the level of future expected profits through their effects on the fee income with consequential impact on the amortisation of DAC.

The level of acquisition costs carried in the statement of financial position is also sensitive to unrealised valuation movements on debt securities held to back the liabilities and solvency capital. Further details are explained in notes D3(g) and H1 to the consolidated financial statements in Item 18.

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As explained in note A5 to the consolidated financial statements in Item 18, the Group has adopted the US Financial Accounting Standards Board measurement and recognition requirements in Accounting Standards Update No 2010-26 on 'Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts' from 1 January 2012 into its IFRS reporting for the results of Jackson and those Asia operations whose IFRS insurance assets and liabilities are measured principally by reference to US GAAP principles. Under the Update insurers are required to capitalise only those incremental costs directly relating to acquiring a contract from 1 January 2012. For Group IFRS reporting Prudential has chosen to apply this new basis retrospectively for the results of these operations.

On adoption of the new DAC policy for Jackson the deferred costs balance for business in force at 31 December 2011 was retrospectively reduced from £3,880 million to £3,095 million (31 December 2010: DAC balance reduced from £3,543 million to £2,829 million).

Asia operations

For those territories applying US GAAP to insurance assets and liabilities, as permitted by the ABI SORP, principles similar to those set out in the Jackson paragraph above are applied to the deferral and amortisation of acquisition costs. For other territories in Asia, the general principles of the ABI SORP are applied with, as described above, deferral of acquisition costs being either explicit or implicit through the reserving basis.

Other features of IFRS accounting that are of particular significance to an understanding of Prudential's results

The other features that are of particular significance relate to: the timing of adoption of certain IFRS standards and their consequential impact upon the financial statements; the accounting for UK with-profits funds; and the presentation of certain items in the financial statements.

Insurance contract accounting

With the exception of certain contracts described in note D1 to the consolidated financial statements in Item 18, the contracts issued by the Group's life assurance business are classified as insurance contracts and investment contracts with discretionary participating features. As permitted by IFRS 4, assets and liabilities of these contracts are accounted for under previously applied GAAP. Accordingly, except as described below, the modified statutory basis (MSB) of reporting as set out in the revised Statement of Recommended Practice (SORP) issued by the Association of British Insurers (ABI) in 2003 has been applied.

With-profits funds

With-profits funds are those in which the policyholder have a contractual right to receive at the discretion of the insurer, additional benefits based on factors such as the performance of a pool of assets held within the fund as a supplement to any guaranteed benefits.

UK regulated with-profits funds

For Group IFRS reporting, UK regulated with-profits funds are accounted for by the voluntary application of the UK accounting standard FRS 27, 'Life Assurance'. Under this standard, for such funds, policyholder liabilities are measured on a 'realistic basis' as discussed in section 2(a) of this note.

Unallocated surplus of with-profits funds:

Unallocated surplus represents the excess of assets over policyholder liabilities for the Group's with-profits funds that have yet to be appropriated between policyholders and shareholders. The Group

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has elected to account for unallocated surplus wholly as a liability with no allocation to equity. This treatment reflects the fact that shareholders' participation in the cost of bonuses arises only on distribution. The unallocated surplus is shown separately in the statement of financial position.

Overseas operations:

For Jackson, applying the MSB as applicable to overseas operations, which permits the application of local GAAP in some circumstances, the assets and liabilities of insurance contracts are accounted for under insurance accounting prescribed by US GAAP. For the assets and liabilities of insurance contracts of Asian operations, the local GAAP is applied with adjustments, where necessary, to comply with UK GAAP. For the operations in India, Japan, Taiwan and, until 2012, Vietnam, (as discussed in note A5 to the consolidated financial statements in Item 18) the local GAAP is not appropriate in the context of the previously applied MSB. For these countries the insurance assets and liabilities are measured principally by reference to US GAAP. For participating business the liabilities include provisions for the policyholders' interest in investment gains and other surpluses that have yet to be declared as bonuses.

The usage of these bases of accounting has varying effects on the way in which product options and guarantees are measured. For UK regulated with-profits funds, options and guarantees are valued on a market consistent basis. The basis is described in note A3(2) to the consolidated financial statements in Item 18. For other operations a market consistent basis is not applied under the accounting basis described in note A3(2)(a) to the consolidated financial statements in Item 18. Details of the guarantees, basis of setting assumptions, and sensitivity to altered assumptions are described in notes D3 and D4 to the consolidated financial statements in Item 18.

Additional details on the Group's accounting policies for insurance assets and liabilities are shown in note A3(2) to the consolidated financial statements in Item 18.

Valuation and accounting presentation of fair value movements of derivatives and debt securities of Jackson

These policies are critical because of their significance to the volatility of the income statement result and shareholders' equity. Under IAS 39, derivatives are required to be carried at fair value. Unless net investment hedge accounting is applied, value movements on derivatives are recognised in the income statement.

For derivative instruments of Jackson, the Group has considered whether it is appropriate to undertake the necessary operational changes to qualify for hedge accounting so as to achieve matching of value movements in hedging instruments and hedged items in the performance statements. In reaching the decision a number of factors were particularly relevant. These were:

- IAS 39 hedging criteria have been designed primarily in the context of hedging and hedging instruments that are assessable as financial instruments that are either stand-alone or separable from host contracts, rather than, for example, duration characteristics of insurance contracts;

- the high hurdle levels under IAS 39 of ensuring hedge effectiveness at the level of individual hedge transactions;

- the difficulties in applying the macro hedge provisions under IAS 39 (which are more suited to banking arrangements) to Jackson's derivative book;

- the complexity of asset and liability matching of US life insurers such as those with Jackson's product range; and finally

- whether it is possible or desirable, without an unacceptable level of costs and constraint on commercial activity, to achieve the accounting hedge effectiveness required under IAS 39.

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Taking account of these considerations the Group has decided that, except for occasional circumstances, it is not appropriate to seek to achieve hedge accounting under IAS 39. As a result of this decision the total income statement results are more volatile as the movements in the value of Jackson's derivatives are reflected within it. This volatility is reflected in the level of short-term fluctuations in investment returns, as shown in note B1 to the consolidated financial statements in Item 18.

Under IAS 39, unless carried at amortised cost (subject to impairment provisions where appropriate) under the held-to-maturity category, debt securities are also carried at fair value. The Group has chosen not to classify any financial assets as held-to-maturity. Debt securities of Jackson are designated as available-for-sale with value movements, unless impaired, being recorded as movements within other comprehensive income. Impairments are recorded in the income statement.

Presentation of results before tax

The total tax charge for the Group reflects tax that in addition to relating to shareholders' profits is also attributable to policyholders and unallocated surplus of with-profits funds and unit-linked policies. This is explained in more detail in note F5 to the consolidated financial statements in Item 18. Reported profit before the total tax charge is not representative of pre-tax profits attributable to shareholders. Accordingly, in order to provide a measure of pre-tax profits attributable to shareholders the Group has chosen to adopt an income statement presentation of the tax charge and pre-tax results that distinguishes between policyholder and shareholder components.

Segmental analysis of results and earnings attributable to shareholders

The Group uses operating profit based on longer-term investment returns as the segmental measure of its results. The basis of calculation is disclosed in the section of this Item 5 'Results of Operations and Financial Condition' entitled 'Analysis of IFRS basis operating profit based on longer-term investment returns and IFRS total profit in note A3(2)(d) to the consolidated financial statements in Item 18.

For shareholder-backed business, with the exception of debt securities held by Jackson and assets classified as loans and receivables at amortised cost, all financial investments and investment property are designated as assets at fair value through profit and loss. The short-term fluctuations affect the result for the year and the Group provides additional analysis of results before and after short-term fluctuations in investment returns, together with other items that are of a short-term volatile or one-off nature. Short-term fluctuations in investment returns on such assets held by with-profits funds, do not affect directly reported shareholder results. This is because (i) the unallocated surplus of with-profits funds is accounted for as a liability and (ii) excess or deficits of income and expenditure of the funds over the required surplus for distribution are transferred to or from unallocated surplus.

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Summary Consolidated Results and Basis of Preparation of Analysis

The following table shows Prudential's consolidated total profit for the years indicated.

	Year Ended 31 December		
	2012	**2011***	**2010***
	£m	**£m**	**£m**
Total revenue, net of reinsurance	**55,476**	36,506	47,646
Total charges, net of reinsurance	**(52,288)**	(34,695)	(45,764)
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)***	**3,188**	1,811	1,882
Tax attributable to policyholders' returns	**(378)**	17	(611)
Profit before tax attributable to shareholders	**2,810**	1,828	1,271
Tax charge	**(991)**	(392)	(571)
Less: tax attributable to policyholders' returns	**378**	(17)	611
Tax charge attributable to shareholders' returns	**(613)**	(409)	40
Profit for the year	**2,197**	1,419	1,311

*

The 2011 and 2010 comparative results have been adjusted from those previously published for the retrospective application of the change in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

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

Under IFRS, the pre-tax GAAP measure of profits is profit before policyholder and shareholder taxes. This measure is not relevant for reflecting pre-tax results attributable to shareholders for two reasons. Firstly, this profit measure represents the aggregate of pre-tax results attributable to shareholders and a pre-tax amount attributable to policyholders. Secondly, the amount is determined after charging the transfer to the liability for unallocated surplus, which in turn is determined in part by policyholder taxes borne by the ring-fenced with-profits funds. It is noted that this circular feature is specific to with-profits funds in the UK, and other similarly structured overseas funds, and should be distinguished from other products, which are referred to as 'with-profits' and the general accounting treatment of premium or other policy taxes.

Accordingly, Prudential has chosen to explain its consolidated results by reference to profits for the year, reflecting profit after tax. In explaining movements in profit for the year, reference is made to trends in profit before shareholder tax and the shareholder tax charge. The explanations of movement in profit before shareholder tax are shown below by reference to the profit analysis applied for segmental disclosure as shown in note B1 of the consolidated financial statements in Item 18. This basis is used by management and reported externally to

Prudential's UK, Hong Kong and Singapore shareholders and to the UK, Hong Kong and Singapore financial markets. Separately, in this section, analysis of movements in profits before shareholder tax is provided by nature of revenue and charges.

Explanation of Movements in Profits After Tax and Profits Before Shareholder Tax by Reference to the Basis Applied for Segmental Disclosure

(a) Group overview

Profit for the year after tax for 2012 was £2,197 million compared to £1,419 million for 2011. The increase of £778 million reflects the movement in total profit before tax attributable to shareholders,

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which improved from a profit of £1,828 million in 2011 to £2,810 million in 2012, partially offset by an increase in tax charge attributable to shareholders from £409 million in 2011 to £613 million in 2012. The improvement in total profit before tax attributable to shareholders reflects the increase in operating profit based on longer-term investment returns and the positive investment market returns earned in the year.

The effective rate of tax at the total profit level was 22 per cent in 2012 which is the same as 2011. In both 2012 and 2011, Prudential has benefited from the favourable impact of certain income in some Asian jurisdictions either not being taxable or being taxable at reduced rates. In addition, Prudential has benefitted from ongoing reductions in the main UK corporate tax rate from 28 per cent in 2010 to 26 per cent in 2011 to 24 per cent in 2012. Further details are provided in note F5 to the consolidated financial statements in Item 18.

The total profit before tax attributable to shareholders was £1,828 million in 2011, compared with £1,271 million in 2010. The improvement reflects the increase in operating profit based on longer-term investment returns, and the fact that in 2010 the profit was reduced by the terminated AIA transaction costs of £377 million.

The effective rate of tax at the total profit level was 22 per cent in 2011, compared to negative 3 per cent in 2010. In 2010 tax charge attributable to shareholders' profit included a credit of £158 million which primarily relates to the impact of a settlement agreed with the UK authorities. Adjusting the rate in 2010 to exclude the exceptional tax credit of £158 million gives an underlying tax rate at the total profit level for 2010 of 9 per cent. In both 2011 and 2010, Prudential has benefited from a reduction in the main UK corporate tax rate from 28 per cent to 26 per cent offset by an increase in the Asia tax rate following the resolution of outstanding issues. Further details are provided in note F5 to the consolidated financial statements in Item 18.

(b) Summary by business segment and geographical region

The Group's operating segments as determined under IFRS 8 are insurance operations split by territories in which the Group conducts business, which are Asia, the United States and the United Kingdom, and asset management operations split into M&G, which is the Group's UK and European asset management business, Eastspring Investments, which is the Asian asset management business and the US broker-dealer and asset management business (including Curian).

The following table shows Prudential's IFRS consolidated total profit/(loss) for the years indicated presented by summary business segment and geographic region. The accounting policies applied to the segments below are the same as those used in the Group's consolidated accounts.

	Year ended 31 December 2012				
	Asia	**US**	**UK**	**Unallocated corporate**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Insurance operations	**831**	**621**	**697**		**2,149**
Asset management**	**58**	**18**	**411**		**487**
Total profit attributable to the segments	**889**	**639**	**1,108**		**2,636**
Unallocated corporate				**(439)**	**(439)**
Total profit (loss) for the year	**889**	**639**	**1,108**	**(439)**	**2,197**

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	Year ended 31 December 2011*				
	Asia	US	UK	Unallocated corporate	Total
	£m	£m	£m	£m	£m
Insurance operations	488	357	671		1,516
Asset management**	62	16	235		313
Total profit attributable to the segments	550	373	906		1,829
Unallocated corporate				(410)	(410)
Total profit (loss) for the year	550	373	906	(410)	1,419

	Year ended 31 December 2010*				
	Asia	US	UK	Unallocated corporate	Total
	£m	£m	£m	£m	£m
Insurance operations	572	221	646		1,439
Asset management**	57	13	237		307
Total profit attributable to the segments	629	234	883		1,746
Unallocated corporate***				(435)	(435)
Total profit (loss) for the year	629	234	883	(435)	1,311

*
The 2011 and 2010 comparative results have been adjusted from those previously published for the retrospective application of the change in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

**
For the US, including the broker dealer business and Curian.

***
The results for the unallocated corporate for the year ended 31 December 2010 included the impact of the costs of the terminated AIA transaction.

Profit from insurance operations

Total profit from insurance operations in 2012 was £2,149 million compared to £1,516 million in 2011 and £1,439 million in 2010. All of the profits from insurance operations in 2012, 2011 and 2010 were from continuing operations. The movement in profits for insurance operations can be summarised as follows:

	Year Ended 31 December		
	2012	**2011***	**2010***
	£m	**£m**	**£m**
Profit before shareholder tax	**2,702**	1,996	1,771
Shareholder tax	**(553)**	(480)	(332)
Profit after tax	**2,149**	1,516	1,439

* The 2011 and 2010 comparative results have been adjusted from those previously published for the retrospective application of the change in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

The increase of £706 million in profit before tax attributable to shareholders in 2012 compared to 2011 reflects an increase in operating profits based on longer term investment returns combined with the favourable change in the short-term fluctuations in investment returns for the insurance operations.

The effective shareholder tax rate on profits from insurance operations decreased from 24 per cent in 2011 to 20 per cent in 2012. The decrease primarily relates to an increase in income that is non-taxable or taxable at concessionary rates in Asia, routine revisions to prior period tax returns and

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the reduction in tax rate in the UK, partially offset by adverse revisions to prior period tax returns in the US.

The increase of £225 million in profit before tax attributable to shareholders in 2011 compared to 2010 reflects an increase in operating profits based on longer term investment returns combined with a reduction in the overall negative short-term fluctuations in investment returns for the insurance operations.

The effective shareholder tax rate on profits from insurance operations increased from 19 per cent in 2010 to 24 per cent in 2011. The increase primarily relates to increased profits in the US and the recent fiscal developments in Indonesia affecting the life assurance industry offset by the reduction in the UK tax rate.

In order to understand how Prudential's results are derived it is necessary to understand how profit emerges from its business. This varies from region to region, primarily due to differences in the nature of the products and regulatory environments in which Prudential operates.

Asia

Basis of profits

The assets and liabilities of contracts classified as insurance under IFRS 4 are determined in accordance with methods prescribed by local GAAP and adjusted to comply, where necessary, with UK GAAP. Under IFRS 4, subject to the conditions of that standard, the continued application of UK GAAP in this respect is permitted.

For Asia operations in countries where local GAAP is not well established and in which the business is primarily non-participating and linked business, the measurement of the insurance assets and liabilities is determined substantially by reference to US GAAP principles. This basis is applied in India, Japan, Taiwan and until 2012 Vietnam. For with-profits business in Hong Kong, Singapore and Malaysia, the basis of profit recognition is bonus driven as described under 'United Kingdom Basis of Profits' below.

Comparison of total profit arising from Asia insurance operations

The following table shows the movement in profit arising from Asia insurance operations for 2012, 2011 and 2010:

	Year Ended 31 December		
	2012	**2011***	**2010**
	£m	**£m**	**£m**
Profit before shareholder tax	**989**	612	636
Shareholder tax	**(158)**	(124)	(64)
Profit after tax	**831**	488	572

* The 2011 and 2010 comparative results have been adjusted from those previously published for the retrospective application of the change in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

The 2012 profit before tax attributable to shareholders of £989 million represented an increase of £377 million over 2011 of £612 million. This primarily reflects an increase of £209 million in operating profit based on longer-term investment returns, combined with an improvement in the short-term fluctuations in investment returns for shareholder-backed business of £168 million.

The effective shareholder tax rate changed from 20 per cent in 2011 to 16 per cent in 2012, with the movement principally due to an increase in income that is non-taxable or taxable at concessionary rates.

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The 2011 profit before tax attributable to shareholders of £612 million represented a decrease of £24 million as against the comparable 2010 figure of £636 million which primarily reflects an increase of £182 million in operating profit based on longer-term investment returns offset by an adverse change of £206 million in short-term fluctuations in investment returns for shareholder-backed business.

The effective shareholder tax rate changed from 10 per cent in 2010 to 20 per cent in 2011, with the movement principally due to the recent fiscal developments in Indonesia affecting the life assurance industry.

United States

Basis of profits

The underlying profit on Jackson's business predominantly arises from spread income from interest-sensitive products, such as fixed annuities and institutional products and fee income on variable annuity business with the insurance assets and liabilities of the business measured on a US GAAP basis. In addition, the results in any period include the incidence of gains and losses on assets classified as available-for-sale, and fair value movements on derivatives and securities classified as fair valued through profit and loss.

Comparison of total profit arising from US insurance operations

The following table shows the movement in profit arising from US insurance operations for 2012, 2011 and 2010:

	Year Ended 31 December		
	2012	2011*	2010
	£m	£m	£m
Profit before shareholder tax	**855**	484	275
Shareholder tax	**(234)**	(127)	(54)
Profit after tax	**621**	357	221

* The 2011 and 2010 comparative results have been adjusted from those previously published for the retrospective application of the change in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

The increase in profit before shareholder tax of £371 million in 2012 compared to 2011 was due primarily to an increase of £313 million in operating profit based on longer-term investment returns, combined with a favourable change in the short-term fluctuations in investment returns for shareholder backed business. The profit before shareholder tax in 2012 includes a £61 million contribution from REALIC which was acquired in September 2012, of which the operating profit based on longer-term investment returns was £67 million. Excluding this contribution from REALIC, the remaining year on year increase of £246 million in operating profit based on longer-term investment returns primarily reflects higher fee income generated by growth in the separate account assets, as well as the expected non-recurring impact of accelerated deferred acquisition cost (DAC) amortisation of £190 million in 2011. This has been partially offset by the adverse effect on spread income of lower bond yields.

The effective tax rate on profit from the US insurance operations changed from 26 per cent in 2011 to 27 per cent in 2012 due to adverse revisions to prior period tax returns.

The increase in profit before tax attributable to shareholders of £209 million in 2011 compared to 2010 reflected a decrease of £77 million in operating profit based on longer-term investment returns which was more than offset by a favourable change of £286 million in short-term fluctuations in investment returns reflected in the income statement. The decrease in the operating profit based on longer-term investment returns was due to the accounting impact of accelerated amortization of deferred acquisition costs (DAC) of £190 million in the year. Excluding the impact of accelerated DAC amortisation, the US insurance operations' earnings continued to grow during 2011. The favourable

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change of £286 million in the short-term fluctuations in investment returns was primarily due to lower negative fluctuations from the US operations' derivative hedging programmes in 2011 compared to 2010.

The effective tax rate on profit from the US insurance operations changed from 20 per cent in 2010 to 26 per cent in 2011. The 2010 effective tax rate is comparatively low as there is a larger proportion of non-taxable income.

United Kingdom

Basis of profits

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. For most of Prudential's operations, other than its UK long-term insurance businesses, the IFRS basis of accounting matches items of income and related expenditure within the same accounting period. This is achieved through the deferral of acquisition costs and application of the accruals concept.

With-profits products

For Prudential's UK insurance operations, the primary annual contribution to shareholders' profit comes from its with-profits products. With-profits products are designed to provide policyholders with smoothed investment returns through a mix of regular and final bonuses.

Shareholders' profit in respect of bonuses from with-profits products represents an amount of up to one-ninth of the value of that year's bonus declaration to policyholders. The Board of directors of the subsidiary companies that have with-profits operations, using actuarial advice, determine the amount of regular and final bonuses to be declared each year on each group of contracts. The smoothing inherent in the bonus declarations provides for relatively stable annual shareholders' profit from this business.

Bonus rates

Bonus rates are applied to with-profits policies in the UK and similar products in Singapore, Hong Kong and Malaysia. The most significant with-profits fund is in the UK where, as at 31 December 2012, liabilities to with-profits policyholders were in aggregate of £71 billion. Liabilities to with-profits policyholders in Asia as at 31 December 2012 were £13.4 billion. The details that follow are in respect of the UK with-profits business. The method by which bonuses for Prudential's Asia with-profits business are determined is substantially similar to the method by which bonuses for Prudential's UK with-profits business are determined.

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

Further details on the determination of the two types of bonus ('regular' and 'final'), the application of significant judgment, key assumptions and the degree of smoothing of investment returns in determining the bonus rates are provided below.

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Regular bonus rates

For regular bonuses, the bonus rates are determined for each type of policy primarily by targeting the bonus level at a prudent proportion of the long-term expected future investment return on underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by the date of payment of the premium, or date of issue of the policy, or if the accumulated annual bonuses are particularly high or low, relative to a prudent proportion of the achieved investment return.

When target bonus levels change the PAC board of directors (PAC Board) has regard to the overall strength of the long-term fund when determining the length of time over which it will seek to achieve the amended prudent target bonus level.

In normal investment conditions, PAC expects changes in regular bonus rates to be gradual over time. However, the PAC Directors retain the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

Final bonus rates

A final bonus which is normally declared yearly, may be added when a claim is paid or when units of a unitised product are realised.

The rates of final bonus usually vary by type of policy and by reference to the period, usually a year, in which the policy commences or each premium is paid. These rates are determined by reference to the asset shares for the sample policies but subject to the smoothing approach as explained below.

In general, the same final bonus scale applies to maturity, death and surrender claims except that:

- The total surrender value may be impacted by the application of a Market Value Reduction for accumulating with-profits policies and is the surrender bases for conventional with-profits business; and

- For the SAIF and Scottish Amicable, the final bonus rates applicable on surrender may be adjusted to reflect expected future bonus rates.

Application of significant judgement

The application of the above method for determining bonuses requires the PAC Board to apply significant judgement in many respects, including in particular the following:

- Determining what constitutes fair treatment of customers: Prudential is required by UK law and regulation to consider the fair treatment of its customers in setting bonus levels. The concept of determining what constitutes fair treatment, while established by statute, is not defined;

- Smoothing of investment returns: This is an important feature of with-profits products. Determining when particular circumstances, such as a significant rise or fall in market values, warrant variations in the standard bonus smoothing limits that apply in normal circumstances requires the PAC Board to exercise significant judgement; and

- Determining at what level to set bonuses to ensure that they are competitive: The overall return to policyholders is an important competitive measure for attracting new business.

Key assumptions

As noted above, the overall rate of return on investments and the expectation of future investment returns are the most important influences in bonus rates, subject to the smoothing described below. Prudential determines the assumptions to apply in respect of these factors, including the effects of

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reasonably likely changes in key assumptions, in the context of the overarching discretionary and smoothing framework that applies to its with-profits business as described above. As such, it is not possible to specifically quantify the effects of each of these assumptions, or of reasonably likely changes in these assumptions.

Prudential's approach, in applying significant judgement and discretion in relation to determining bonus rates, is consistent conceptually with the approach adopted by other firms that manage a with-profits business. It is also consistent with the requirements of UK law, which require all UK firms that carry out a with-profits business to define, and make publicly available, the Principles and Practices of Financial Management (PPFM) that are applied in the management of their with-profits funds.

Accordingly, Prudential's PPFM contains an explanation of how it determines regular and final bonus rates within the discretionary framework that applies to all with-profits policies, subject to the general legislative requirements applicable. The purpose of Prudential's PPFM is therefore to:

- explain the nature and extent of the discretion available,
- show how competing or conflicting interests or expectations of different groups and generations of policyholders, and policyholders and shareholders are managed so that all policyholders and shareholders are treated fairly, and
- provide a knowledgeable observer (eg a financial adviser) with an understanding of the material risks and rewards from starting and continuing to invest in a with-profits policy with Prudential.

Furthermore, in accordance with industry-wide regulatory requirements, the PAC Board has appointed:

- an Actuarial Function Holder who provides the PAC Board with all actuarial advice;
- a With-Profits Actuary whose specific duty is to advise the PAC Board on the reasonableness and proportionality of the manner in which its discretion has been exercised in applying the PPFM and the manner in which any conflicting interests have been addressed; and
- a With-Profits Committee of independent individuals, which assesses the degree of compliance with the PPFM and the manner in which conflicting rights have been addressed.

Smoothing of investment return

In determining bonus rates for the UK with-profits policies, smoothing is applied to the allocation of the overall earnings of the UK with-profits fund of which the investment return is a significant element. The smoothing approach differs between accumulating and conventional with-profits policies to reflect the different contract features. In normal circumstances, Prudential does not expect most payout values on policies of the same duration to change by more than 10 per cent up or down from one year to the next, although some larger changes may occur to balance payout values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values, and in such situations the PAC Board may decide to vary the standard bonus smoothing limits in order to protect the overall interests of policyholders.

The degree of smoothing is illustrated numerically by comparing in the following table the relatively 'smoothed' level of policyholder bonuses declared as part of the surplus for distribution, with the more

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volatile movement in investment return and other items of income and expenditure of the UK component of the PAC with-profits fund for each year presented.

	2012	2011	2010
	£m	£m	£m
Net income of the fund:			
Investment return	**8,350**	4,094	8,815
Claims incurred	**(6,857)**	(6,411)	(6,390)
Movement in policyholder liabilities	**(3,989)**	(614)	(4,301)
Add back policyholder bonuses for the year (as shown below)	**1,865**	1,945	2,019
Claims incurred and movement in policyholder liabilities (including charge for provision for asset shares and excluding policyholder bonuses)	**(8,981)**	(5,080)	(8,672)
Earned premiums, net of reinsurance	**4,558**	3,404	3,148
Other income	**39**	17	9
Acquisition costs and other expenditure	**(740)**	(696)	(600)
Tax charge	**(292)**	(63)	(528)
Net income of the fund before movement in unallocated surplus	**2,934**	1,676	2,172
Movement in unallocated surplus	**(863)**	485	70
Surplus for distribution	**2,071**	2,161	2,242
Surplus for distribution allocated as follows:			
90% policyholders' bonus (as shown above)	**1,865**	1,945	2,019
10% shareholders' transfers	**206**	216	223
	2,071	2,161	2,242

Unallocated surplus

The unallocated surplus represents the excess of assets over policyholder liabilities for the Group's with-profits funds. As allowed under IFRS 4, the Group has opted to continue to record unallocated surplus of with-profits funds wholly as a liability. The annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders, is transferred to (from) the unallocated surplus each year through a charge (credit) to the income statement. The balance retained in the unallocated surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance of the unallocated surplus is determined after full provision for deferred tax on unrealised appreciation on investments.

Changes to the level of the unallocated surplus do not directly impact shareholders' results or funds. After allowing for differences in the basis of preparation of the financial information and UK regulatory returns, movements in the level of the unallocated surplus are broadly indicative of movements in the excess of regulatory basis assets over liabilities of the fund. Differences in the basis of preparation of financial statements and UK regulatory returns arise principally from the treatment of certain regulatory basis liabilities, such as mismatching reserves (that are accounted for as reserves within the unallocated surplus), and asset valuation differences and admissibility deductions reflected in the regulatory returns. Except to the extent of any second order effects on other elements of the regulatory returns, such changes can be expected to have a consequent effect on the excess of assets over liabilities of the fund for the purposes of solvency calculations, and the related free asset ratio which is an indicator of the overall financial strength of the fund. Similar principles apply to Prudential's Asian with-profits business.

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Surplus assets and their use

The liability for unallocated surplus comprises amounts Prudential expects to pay to policyholders in the future, the related shareholder transfers and surplus assets. These surplus assets have accumulated over many years from a variety of sources and provide the with-profits fund with working capital. This working capital permits 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 historical pensions mis-selling, without affecting the level of distributions to policyholders and shareholders. The costs of fundamental strategic change may include investment in new technology, redundancy and restructuring costs, cost overruns on new business and the funding of other appropriate long-term insurance related activities, including acquisitions.

The 'SAIF' and 'PAL' funds

Prudential's with-profits fund also includes the SAIF and the wholly-owned subsidiary, PAL. All assets of the SAIF business are solely attributable to former policyholders of Scottish Amicable Life Assurance Society (predating the acquisition of Scottish Amicable by Prudential in October 1997). Since PAL is a wholly-owned subsidiary of the with-profits fund, profits from this business affect shareholders' profits only to the extent that they affect the annual with-profits bonus declaration and resultant transfer to shareholders.

Accounting for with-profits business

For with-profits business (including non-participating business of Prudential Annuities Limited which is owned by the PAC with-profits fund), adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on the annual declaration of bonuses, shareholder profit for with-profits business is unaffected. This is because IFRS basis profits for the with-profits business, which are determined on the same basis as on preceding UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year.

Fair value of assets

Changes in the fair value of assets of Prudential's long-term with-profits funds will primarily be reflected in the excess of assets over liabilities recorded as the unallocated surplus. Shareholders' profits from with-profits business and shareholders' funds are not directly impacted by movements in the fair values of the assets. However, current investment performance is a factor that is taken into account in the setting of the annual declaration of bonuses which, in turn, affects UK shareholder profits to the extent of one-ninth of the cost of bonus.

Investment returns

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

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UK shareholder-backed annuity business

The results for this type of business are prepared in accordance with the UK Modified Statutory Basis. The results reflect the inclusion of investment return including realised and unrealised gains. The charge for benefits reflects the valuation rate of interest applied to discount future anticipated payments to policyholders. This rate in turn reflects current market yields adjusted for factors including default risks on the assets backing the liabilities. The level of allowance for default risk is a key assumption. Details are included in note D2 of the consolidated financial statements in Item 18.

Comparison of total profit arising from UK insurance operations

The following table shows the movement in profit arising from UK insurance operations for 2012, 2011 and 2010:

	Year Ended 31 December		
	2012	**2011**	**2010**
	£m	**£m**	**£m**
Profit before shareholder tax	**858**	900	860
Shareholder tax	**(161)**	(229)	(214)
Profit after tax	**697**	671	646

Profit after tax from UK insurance operations of £697 million in 2012 is £26 million higher than the £671 million in 2011.

The decrease in profit before tax attributable to shareholders of £42 million to £858 million in 2012 was primarily due to an adverse change in the value of short-term fluctuations in investment returns of the shareholder-backed business of £23 million which reflects asset value movements principally on the shareholder-backed annuity business and a decrease of £32 million in the actuarial and other gains on defined benefit pension schemes from a gain of £18 million in 2011 to a loss of £14 million in 2012. These decreases were partially offset by an increase in operating profit based on longer-term investments returns of £13 million in 2012. Operating profit based on longer-term investment returns of £736 million included general insurance commissions which decreased by £7 million to £33 million in 2012 compared with £40 million for 2011.

The effective shareholder tax rate on profits from UK insurance operations for 2012 of 19 per cent compares with an effective tax rate of 25 per cent in 2011, with the movement principally due to routine revisions to prior period tax returns and the reduction in the UK rate of tax.

The increase in profit before tax attributable to shareholders of £40 million from £860 million in 2010 to £900 million in 2011 reflected an increase of £4 million in operating profit based on longer-term investment returns, a favourable change of £43 million in the value of short-term fluctuations in investment returns of the shareholder-backed business and a favourable change of £23 million in the shareholders' share of actuarial gains/losses in defined benefit pension schemes. These increases were partially offset by a non-recurring £30 million gain recorded in 2010 upon the dilution of the UK insurance operations' holding in PruHealth, as described further below under section (c) "Explanation of Movements in Profits After Tax and Profits Before Shareholder Tax by Reference to the Basis Applied for Segmental Disclosure".

The effective shareholder tax rate on profits from UK insurance operations for 2011 of 25 per cent is consistent with an effective tax rate of 25 per cent in 2010. The rate in 2011 remained the same as 2010 primarily due to adverse routine reversions to prior period tax returns being offset by the reduction in the UK tax rate.

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Profit from asset management

The following table shows the movement in profits from asset management for 2012, 2011 and 2010:

	Year Ended 31 December		
	2012	**2011**	**2010**
	£m	**£m**	**£m**
Profit before shareholder tax	**635**	436	420
Shareholder tax	**(148)**	(123)	(113)
Profit after tax	**487**	313	307

Total profit from asset management increased from £313 million in 2011 to £487 million in 2012. The £199 million increase in profit before tax attributable to shareholders resulted mainly from an increase in profit generated by M&G, which increased profit before tax of £332 million in 2011 to £521 million in 2012. The profit before tax attributable to shareholders for Eastspring Investments reduced by £5 million from £80 million in 2011 to £75 million in 2012. Profits generated by the US broker dealer and asset management operations increased by £15 million from £24 million in 2011 to £39 million in 2012.

The £189 million increase in profit before tax attributable to M&G was the result of a favourable change in short term fluctuations in investment returns of £122 million compared with 2011, an increase in operating profit based on longer-term investment returns of £14 million, an improvement in the actuarial gains on defined benefit schemes of £11 million and a one-off gain of £42 million arising on the dilution of M&G's investment holding in PPM South Africa. Further detail on the change in investment holdings in PPM South Africa is given in note I2 to the consolidated financial statements in Item 18.

The effective tax rate on profits from asset management operations changed from 28 per cent in 2011 to 23 per cent in 2012 principally due to the gain arising on the dilution of M&G's investment holding in PPM South Africa being non taxable.

Profit before tax attributable to shareholders from asset management increased from £420 million in 2010 to £436 million in 2011. The £16 million increase in profit before tax attributable to shareholders from 2010 to 2011 reflects improvements experienced across M&G of £6 million, Eastspring Investments of £8 million and the US broker-dealer and asset management operations of £2 million.

The £6 million increase in profit before tax attributable to M&G reflected an increase of £73 million in operating profit based on longer-term investment returns from £284 million in 2010 to £357 million in 2011, which was due to rising revenues and a fall in the cost-income ratio. Further, the increase also reflected a favourable change in actuarial gains/losses on defined benefit pension scheme of £9 million. These increases were partially offset by a negative year on year change in the short-term fluctuations of £76 million.

The effective tax rate on profits from asset management operations increased slightly from 27 per cent in 2010 to 28 per cent in 2011.

Unallocated corporate result

The following table shows the movement in the unallocated corporate result for 2012, 2011 and 2010.

	Year Ended 31 December		
	2012	**2011**	**2010**
	£m	**£m**	**£m**
Loss before shareholder tax	**(527)**	(604)	(920)
Shareholder tax	**88**	194	485
Loss after tax	**(439)**	(410)	(435)

Total net charges for unallocated corporate activity increased by £29 million from £410 million in 2011 to £439 million in 2012 and reduced by £25 million from £435 million in 2010 to £410 million in 2011.

The loss before shareholder tax reduced by £77 million from £604 million at 2011 to £527 million at 2012. Net other expenditure (including restructuring and Solvency II implementation costs) increased by £53 million from a charge of £512 million in 2011 to a charge of £565 million in 2012. This was more than offset by a favourable change of £80 million in short-term fluctuations in investment returns from £91 million loss in 2011 to £11 million loss in 2012 and a favourable change in actuarial and other gains on defined benefit pension schemes of £50 million, from a loss of £1 million in 2011 to a gain of £49 million in 2012. The gain of £49 million on defined benefit pension schemes in 2012 reflected the partial recognition of actuarial surplus of PSPS following the results of its triennial valuation.

The 2011 net other expenditure included a credit of £42 million resulting from the Prudential's alteration of its inflation measure basis for future statutory increases to pension payments for certain tranches of Prudential's UK defined benefit schemes. This reflected the UK Government's decision to replace the RPI basis of indexation with the CPI.

The effective tax rate on unallocated corporate result (being a tax credit on a loss) changed from 32 per cent in 2011 to 17 per cent in 2012, principally due to an increase in provisions for open tax matters and by the reduction in the UK rate of tax.

The loss before shareholder tax in 2010 of £920 million included costs of £377 million incurred in relation to the terminated transaction to purchase AIA Group Limited. Further details of these costs are presented in note B1 of consolidated financial statements in Item 18 of this annual report. Excluding these termination costs, the loss before shareholder tax increased by £61 million from 2010 to 2011. The year-on-year movement resulted from a favourable movement of £9 million in other income and expenditure (including restructuring and Solvency II implementation costs) from £521 million in 2010 to £512 million in 2011 which was more than offset by a negative change in short-term fluctuations in investment returns of £69 million and small negative change of £1 million in the actuarial gains and losses of Prudential's defined benefit pension scheme.

The favourable movement of £9 million in net other expenditure includes a credit of £42 million resulting from Prudential's alteration of its inflation measure basis for future statutory increases to pension payments for certain tranches of Prudential's UK defined benefit schemes. This reflects the UK Government's decision to replace the Retail Prices Index (RPI) basis of indexation with the Consumer Prices Index (CPI).

The effective tax rate on unallocated corporate result (being a tax credit on a loss) decreased from 53 per cent in 2010 to 32 per cent in 2011. This was primarily due to 2010 containing both an exceptional UK tax credit primarily relating to the impact of the settlement agreed with the UK tax authorities and the ability to recognise a deferred tax credit on various tax losses which Prudential was previously unable to recognise.

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(c) Additional explanation of performance measures and analysis of consolidated results by business segment and geographical region

Prudential uses a performance measure of operating profit based on longer-term investment returns. The directors believe that this performance measure better reflects underlying performance. It is the basis used by management for the reasons outlined below. It is also the basis on which analysis of the Group's results has been provided to UK shareholders and the UK financial market for some years under long standing conventions for reporting by proprietary UK life assurers.

Prudential determines and presents operating segments based on the information that is internally provided to the Group Executive Committee ('GEC'), which is Prudential's chief operating decision maker.

An operating segment is a component of Prudential that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of Prudential's other components. An operating segment's operating results are reviewed regularly by the GEC to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

The operating segments identified by Prudential reflect its organisational structure, which is by both geography (Asia, US and UK) and by product line (insurance operations and asset management).

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

Insurance operations

- Asia
- US (Jackson)
- UK

Asset management operations

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

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

The performance measure of operating segments utilised by the Company is IFRS operating profit attributable to shareholders based on longer-term investment returns, as described below. This measure excludes the recurrent items of short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. In addition for 2012 this measure excluded a gain arising upon the dilution of the Group's holding in PPM South Africa and the amortisation of the acquisition accounting adjustments arising on the purchase of REALIC as described further in note I1 to the Prudential's consolidated financial statements in Item 18. Further for 2010, this measure excluded costs associated with terminated AIA transaction and gain arising upon the dilution of the Group's holding in PruHealth. Operating earnings per share is based on operating profit based on longer-term investment returns, after tax and non-controlling interests. Further details on the determination of the performance measure of operating profit based on longer-term investment returns is provided below and in note A3(d) to the consolidated financial statements in Item 18.

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Segment results that are reported to the Group Executive Committee include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and the Asia Regional Head Office.

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

Assets backing UK annuity business liabilities. For UK annuity business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the 'operating results based on longer-term investment returns'. Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

Assets backing unit-linked and US variable annuity business separate account liabilities. For such business, the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly, the operating results based on longer-term investment returns reflect the current period value movements in unit liabilities and the backing assets.

In the case of other shareholder-financed business, the measurement of operating profit based on longer-term investment returns reflects the particular features of long-term insurance business where assets and liabilities are held for the long-term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance of life businesses exclusive of the effects of short-term fluctuations in market conditions. In determining the profit on this basis, the following key elements are applied to the results of the Group's shareholder-financed operations as reflected in the segment results shown in note B1.

i Debt, equity-type securities and loans

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

In principle, for debt securities and loans, the longer-term capital returns comprise two elements. The first element is a risk margin reserve (RMR) based charge for the expected level of defaults for the period, which is determined by reference to the credit quality of the portfolio. The difference between impairment losses in the reporting period and the RMR charge to the operating result is reflected in short-term fluctuations in investment returns. The second element is for the amortisation of interest-related realised gains and losses to operating results based on longer-term investment returns to the date when sold bonds would have otherwise matured.

Jackson is the shareholder-backed operation for which the distinction between impairment losses and interest-related realised gains and losses is in practice relevant to a significant extent. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) developed by external third parties such as PIMCO or BlackRock Solutions to determine the average annual RMR to apply to debt securities held to back general account business. Debt securities held to back separate account and reinsurance funds withheld are not subject to RMR charge. Further details of the RMR charge, as well as the amortisation of interest-related realised gains and losses, for Jackson are shown in note B1(iv) to the consolidated financial statements in Item 18.

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

At 31 December 2012, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £498 million (31 December 2011: net gain of £462 million;31 December 2010: net gain of £373 million).

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

As at 31 December 2012, the equity-type securities for US insurance non-separate account operations amounted to £1,004 million (31 December 2011: £902 million; 2010: £852 million). For these operations, the longer-term rates of return for income and capital applied in 2012, 2011 and 2010, which reflect the combination of risk free rates and appropriate risk premiums are as follows:

	2012	**2011**	**2010**
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	**5.5% to 6.2%**	5.9% to 7.5%	6.5% to 7.9%
Other equity-type securities such as investments in limited partnerships and private equity funds	**7.5% to 8.2%**	7.9% to 9.5%	8.5% to 9.9%

For Asia insurance operations, investments in equity securities held for non-linked shareholder-financed operations amounted to £659 million as at 31 December 2012 (31 December 2011: £590 million; 31 December 2010: £506 million). The rates of return applied in the years 2012 , 2011 and 2010 ranged from 1.0 per cent to 13.8 per cent with the rates applied varying by territory. The investment amounts for 2011 and 2010 of £590 million and £506 million, respectively included the Group's investment in China Life Insurance Company of Taiwan (China Life (Taiwan)) of £88 million and £101 million, respectively which was sold in 2012, as described in note B1to the consolidated financial statements in Item 18.

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

ii US variable and fixed index annuity business

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

Fair value movements for equity-based derivatives;

Fair value movements for embedded derivatives for Guaranteed Minimum Withdrawal Benefit (GMWB) 'not for life' and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance (see note);

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Movements in accounts carrying value of Guaranteed Minimum Death Benefit (GMDB) and GMWB 'for life' liabilities, for which, under the 'grandfathered' US GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements;

Fee assessments and claim payments, in respect of guarantee liabilities; and

Related changes to amortisation of deferred acquisition costs for each of the above items.

Note: US operations Embedded derivatives for variable annuity guarantee features

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

iii Other derivative value movements

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

iv Other liabilities to policyholders and embedded derivatives for product guarantees

Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between territories depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities is broadly equivalent in the income statement, and operating profit based on longer-term investments returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (ie after allocated investment return and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

i Hong Kong

For certain non-participating business, the economic features are more akin to asset management products with policyholder liabilities reflecting asset shares over the contract term. For these products, the charge for policyholder benefits in the operating results should reflect the asset share feature rather

than volatile movements that would otherwise be reflected if the local regulatory basis (which is applied for IFRS balance sheet purposes) was used.

For other Hong Kong non-participating business, longer term interest rates are used to determine the movement in policyholder liabilities for determining operating results. Similar principles apply for other Asia operations.

ii Japan Guaranteed Minimum Death Benefit (GMDB) product features

For unhedged GMDB liabilities accounted for under IFRS using 'grandfathered' US GAAP, such as in the Japanese business, the change in carrying value is determined under FASB ASC subtopic 944-80, Financial Services Insurance Separate Accounts (formerly SOP 03-1), which partially reflects changes in market conditions. Under the company's segmental basis of reporting the operating profit reflects the change in liability based on longer-term market conditions with the difference between the charge to the operating result and the movement reflected in the total result included in short-term fluctuations in investment returns.

UK shareholder-backed annuity business

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

- The impact on credit risk provisioning of actual upgrades and downgrades during the period;
- Credit experience compared to assumptions
- Short-term value movements on assets backing the capital of the business.

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Negative experience compared to assumptions is included within short-term fluctuations in investment returns without further adjustment. This is to be contrasted with positive experience where surpluses are retained in short-term allowances for credit risk for IFRS reporting purposes. The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

v Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply. For these businesses it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include realised gains and losses (including impairments) in the operating result with unrealised gains and losses being included in short-term fluctuations. For this purpose impairments are calculated as the credit loss determined by comparing the projected cash flows discounted at the original effective interest rate to the carrying value. In some instances it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying economic substance of the arrangements.

Actuarial and other gains and losses on defined benefit pension schemes

Actuarial and other gains and losses on defined benefit pension schemes principally reflect short-term value movements on scheme assets and the effects of changes in actuarial assumptions. Under Prudential's accounting policies these items are recorded within the income statement, rather than through other comprehensive income, solely due to the interaction of Prudential's approach to adoption of IFRS 4 for with-profits funds and the requirements of IAS 19.

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Reconciliation of total profit (loss) by business segment and geography to IFRS operating profit based on longer-term investment returns

Analysis of IFRS operating profit based on longer-term investment returns and IFRS total profit

A reconciliation of profit (loss) before tax (including tax attributable to policyholders' returns) to profit (loss) before tax attributable to shareholders and loss for the period is shown below.

	2012	**2011***	**2010***
	£m	**£m**	**£m**
Insurance business			
Long-term business[(ii)]			
Asia	**920**	709	526
US	**964**	651	728
UK	**703**	683	673
Development expenses	**(7)**	(5)	(4)
Long-term business operating profit	**2,580**	2,038	1,923
UK general insurance commission[(iii)]	**33**	40	46
Asset management business			
M&G	**371**	357	284
Eastspring Investments	**75**	80	72
US broker-dealer and asset management	**39**	24	22
	3,098	2,539	2,347
Other income and expenditure	**(498)**	(483)	(450)
RPI to CPI inflation measure change on defined benefit pension schemes[(iv)]		42	
Solvency II implementation costs	**(48)**	(55)	(45)
Restructuring costs[(v)]	**(19)**	(16)	(26)
Total IFRS operating profit based on longer-term investment returns[(i)]	**2,533**	2,027	1,826
Short-term fluctuations in investment returns[(vi)]			
Insurance operations	**122**	(100)	(223)
Other operations	**82**	(120)	25
Total short-term fluctuations in investment returns	**204**	(220)	(198)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes[(vii)]	**50**	21	(10)
Costs of terminated AIA transaction[(viii)]			(377)
Gain on dilution of Group's holdings	**42**		30
Amortisation of acquisition accounting adjustments arising on the purchase of REALIC[(ix)]	**(19)**		
Profit before tax from continuing operations attributable to shareholders	**2,810**	1,828	1,271
Tax (charge) credit attributable to shareholders' returns	**(613)**	(409)	40
Profit for the year	**2,197**	1,419	1,311
Non-controlling interests		(4)	(5)
Total profit for the year attributable to equity holders of Prudential	**2,197**	1,415	1,306

* The 2011 and 2010 comparative results have been adjusted from those previously published for the

retrospective application of the changes in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

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Notes

(i)

Operating profit based on longer-term investment returns

The Group provides supplementary analysis of IFRS profit before tax attributable to shareholders so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. Operating profit based on longer-term investment returns is the basis on which management regularly reviews the performance of Prudential's segments as defined by IFRS 8. Further discussion on the determination of operating profit based on longer-term investment returns is provided in A3(2)(d) of the consolidated financial statements in Item 18 and section c "Additional explanation of performance measures and analysis of consolidated results by business segment and geographical region" above.

(ii)

Effect of changes to assumptions, estimates and bases of determining life assurance liabilities

The results of the Group's long-term business operations are affected by changes to assumptions, estimates and bases of preparation.

These are described in notes D2(g), D3(g) and D4(g) of the consolidated financial statements in Item 18.

(iii)

UK operations transferred its general insurance business to Churchill in 2002, with general insurance commission representing the commission received net of expenses for Prudential-branded general insurance products as part of this arrangement.

(iv)

During 2011 the Group altered its inflation measure basis for future statutory increases to pension payments for certain tranches of its UK defined benefit pension schemes. This reflects the UK Government's decision to replace the basis of indexation from Retail Prices Index (RPI) to the Consumer Prices Index (CPI). This resulted in a credit to operating profit before tax in 2011 of £42 million.

(v)

Restructuring costs are incurred in the UK and represent one-off expenses incurred in securing expense savings.

(vi)

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

	2012	**2011***	**2010***
	£m	**£m**	**£m**
Insurance operations:			
Asia	**76**	(92)	114
US	**(90)**	(167)	(453)
UK	**136**	159	116
Other operations			
Economic hedge value movement	**(32)**		
Other	**114**	(120)	25
Total	**204**	(220)	(198)

*

The 2011 and 2010 comparative results have been adjusted from those previously published for the retrospective application of the change in accounting policy described in note A5 to Prudential's consolidated financial statements in Item 18.

Further details on the short-term fluctuations in investment returns are provided below under 'Charge for short-term fluctuations in investment returns' and also in note B1 in the consolidated financial statements in Item 18.

(vii)

For the 2011 comparatives, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes comprises the aggregate effect of actual less expected returns on scheme assets, experience gains and losses, the effect of changes in assumptions and altered provisions for deficit funding, where relevant. For 2012, these items also apply. However, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes also includes £49 million for the effect of partial recognition of surplus of the main Prudential Staff Pension Scheme (PSPS). This credit arises from altered funding arrangement following the 5 April 2011 triennial valuation. Further details on the Group's defined benefit pension schemes are shown in note I3 to the consolidated financial statements in Item 18.

(viii)

The costs were incurred in the first six months of 2010 in relation to the proposed, and subsequently terminated transaction, to purchase AIA Group Limited and related rights issue. Further details are provided in note B1(x) to the Consolidated financial statements in Item 18.

(ix)

These costs were incurred as a result of the acquisition of Reassure America Life Insurance Company (REALIC) on 4 September 2012.

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Reconciliation of IFRS operating profit based on longer-term investment returns to IFRS total profit

The following tables reconcile Prudential's operating profit based on longer-term investment returns to Prudential's total profit after tax for 2012, 2011 and 2010.

	Year ended 31 December 2012								
	Insurance operations			Asset management					
	UK	US	Asia	M&G	US	Eastspring Investments	Total segment	Unallocated corporate	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Operating profit based on longer-term investment returns	736	964	913	371	39	75	3,098	(565)	2,533
Short-term fluctuations in investment returns on shareholder-backed business	136	(90)	76	93			215	(11)	204
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	(14)			15			1	49	50
Gain on dilution of Group holdings				42					