

PRUDENTIAL PLC  
Form 20-F  
May 11, 2011

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**As filed with the Securities and Exchange Commission on May 11, 2011**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**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 December 31, 2010
- 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**

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(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:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
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 December 31, 2010 was:**

2,545,594,506 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  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

**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  No

**Indicate by check mark whether the registrants have submitted electronically and posted on their 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  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  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

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

\*\*  
This requirement does not apply to the registrant until its fiscal year ending December 31,2011.

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The following table sets forth Prudential's selected consolidated financial data 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") 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 December 31, 2010, 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, 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".

The following table presents the income statement, statement of financial position and other data for and as at the years ended December 31, 2006 to 2010, as presented in accordance with IFRS, and has been derived from Prudential's consolidated financial statements, audited by KPMG Audit Plc:

	<b>Year Ended December 31,</b>					
	<b>2010(1)</b>	<b>2010(1)</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In \$</b>					
	<b>Millions)</b>		<b>(In £ Millions)</b>			
<b>Income statement data</b>						
Gross premium earned	<b>37,815</b>	<b>24,568</b>	20,299	18,993	18,359	16,157
Outward reinsurance premiums	<b>(549)</b>	<b>(357)</b>	(323)	(204)	(171)	(171)
Earned premiums, net of reinsurance	<b>37,266</b>	<b>24,211</b>	19,976	18,789	18,188	15,986
Investment return	<b>33,507</b>	<b>21,769</b>	26,889	(30,202)	12,225	17,141
Other income	<b>2,564</b>	<b>1,666</b>	1,234	1,146	2,457	1,917
<b>Total revenue, net of reinsurance</b>	<b>73,337</b>	<b>47,646</b>	48,099	(10,267)	32,870	35,044
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	<b>(62,365)</b>	<b>(40,518)</b>	(41,195)	10,824	(26,785)	(28,267)
Acquisition costs and other expenditure	<b>(7,387)</b>	<b>(4,799)</b>	(4,572)	(2,459)	(4,859)	(4,489)
Finance costs: interest on core structural borrowings of shareholder-financed operations	<b>(396)</b>	<b>(257)</b>	(209)	(172)	(168)	(177)
Loss on sale of Taiwan agency business			(559)			
<b>Total charges, net of reinsurance</b>	<b>(70,148)</b>	<b>(45,574)</b>	(46,535)	8,193	(31,812)	(32,933)
Profit (loss) before tax ( <i>being tax attributable to shareholders' and policyholders' returns</i> )(2)	<b>3,189</b>	<b>2,072</b>	1,564	(2,074)	1,058	2,111
Tax (charge) credit attributable to policyholders' returns	<b>(940)</b>	<b>(611)</b>	(818)	1,624	5	(830)
<b>Profit (loss) before tax attributable to shareholders</b>	<b>2,249</b>	<b>1,461</b>	746	(450)	1,063	1,281

Tax (charge) credit attributable to shareholders' returns	(39)	(25)	(55)	59	(354)	(365)
Profit (loss) from continuing operations after tax	<b>2,210</b>	<b>1,436</b>	691	(391)	709	916
Discontinued operations (net of tax)			(14)		241	(105)
Profit (loss) for the year	<b>2,210</b>	<b>1,436</b>	677	(391)	950	811

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	As of and for the Year Ended December 31,					
	2010(1)	2010(1)	2009	2008	2007	2006
	(In \$ Millions, Except Share Information)	(In £ Millions, Except Share Information)				
<b>Statement of financial position data</b>						
Total assets	<b>401,433</b>	<b>260,806</b>	227,754	215,542	219,382	216,528
Total policyholder liabilities and unallocated surplus of with-profits funds	<b>346,289</b>	<b>224,980</b>	196,417	182,391	190,317	178,539
Core structural borrowings of shareholder-financed operations	<b>5,658</b>	<b>3,676</b>	3,394	2,958	2,492	3,063
Total liabilities	<b>389,004</b>	<b>252,731</b>	221,451	210,429	213,218	210,972
Total equity	<b>12,429</b>	<b>8,075</b>	6,303	5,113	6,164	5,556
Based on profit (loss) for the year attributable to Prudential's equity holders:						
Basic earnings per share	<b>87.3¢</b>	<b>56.7p</b>	27.0p	(16.0)p	38.7p	33.6p
Diluted earnings per share	<b>87.1¢</b>	<b>56.6p</b>	27.0p	(16.0)p	38.6p	33.6p
Dividend per share declared and paid in reporting period(5)	<b>31.05¢</b>	<b>20.17p</b>	19.2p	18.29p	17.42p	16.44p
Equivalent cents per share(6)(8)		<b>30.15¢</b>	30.62¢	35.36¢	34.70¢	30.74¢
Market price per share at end of period(8)	<b>1,028.19¢</b>	<b>668.0p</b>	640.0p	416.5p	712p	699.5p
Weighted average number of shares (in millions)		<b>2,524</b>	2,501	2,472	2,445	2,413
<b>Other data</b>						
New business:						
Single premium sales(4)(7)	<b>27,978</b>	<b>18,177</b>	14,438	15,071	14,696	13,860
New regular premium sales(3)(4)(7)	<b>2,566</b>	<b>1,667</b>	1,401	1,330	1,155	935
Gross investment product contributions	<b>164,647</b>	<b>106,969</b>	96,057	63,147	53,759	33,894
Funds under management	<b>523,328</b>	<b>340,000</b>	290,000	249,000	267,000	251,000

- (1) Amounts stated in US dollars have been translated from pounds sterling at the rate of \$1.5392 per £1.00 (the noon buying rate in New York City on December 31, 2010).
- (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)



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

(4)

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. Department of Work and Pensions ("DWP") rebate business is classified as single recurrent business. Internal vesting business is classified as new business where the contracts include an open market option.

The 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.

(5)

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 6.61p per share in 2010 (2009: 6.29p, 2008: 5.99p) and a final dividend of 17.24p per share in 2010 (2009: second interim dividend of 13.56p, 2008: 12.91p).

(6)

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

(7)

The new business premiums shown, including the comparative figures, exclude the new business premiums from the Group's Japanese insurance subsidiary, which ceased selling new business with effect from February 15, 2010, and the new business premiums for the Taiwan agency business, which was sold in June 2009, but include amounts for the retained Taiwan bank distribution operation. Japan's new business premiums for the years ended December 31, 2010, 2009 and 2008 are shown in Item 4 "Asian Business".

(8)

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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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, realized profits not previously distributed or capitalized less accumulated, realized 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 (pence)	Interim Dividend (US Dollars)	Final/Second	Final/Second
			Interim* Dividend (pence)	Interim* Dividend (US Dollars)
2006	5.42	0.1028	11.72	0.2317
2007	5.70	0.1153	12.30	0.2424
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	

\*

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 final dividend for 2010 is 17.24 pence per share, subject to the shareholders' approval at the Annual General Meeting to be held on May 19, 2011. The interim dividend for 2010 was 6.61 pence per share. The total dividend for the year, including the interim dividend and the final dividend, amounts to 23.85 pence per share compared with 19.85 pence per share for 2009. In view of the progress that the Group has made in recent years to improve the IFRS operating profitability and free surplus generation of the Group's life and asset management business, the Board has decided to rebase the full year dividend upwards by 4 pence per share, equivalent to an increase of 20 per cent compared to the 2009 total dividend. 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 Prudential's 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.

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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 Euro. 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.

<b>Year ended December 31,</b>	<b>Average rate</b>
2006	1.86
2007	2.01
2008	1.84
2009	1.62
2010	1.54

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:

	<b>High</b>	<b>Low</b>
November 2010	1.63	1.56
December 2010	1.59	1.54
January 2011	1.60	1.55
February 2011	1.62	1.58
March 2011	1.64	1.60
April 2011	1.67	1.61

On May 6, 2011, the latest practicable date prior to this filing, the noon buying rate was £1.00 = \$1.64.

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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 report, 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. Uncertain or negative trends in international economic and investment climates could adversely affect Prudential's business and profitability. The adverse effects of volatility arising from such uncertainty and negative trends, including the unprecedented market dislocation across asset classes and geographical markets witnessed in 2008 and in the first half of 2009, have been and would be felt principally through the following:

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

higher credit defaults and wider credit and liquidity spreads resulting in realized and unrealized credit losses, as experienced during 2008 and 2009, when illiquidity and credit spreads reached all-time highs;

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 are difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realized 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.

During the period of market dislocation in 2008 and the first half of 2009, Prudential had to operate against a challenging background of unprecedented volatility in the global capital and equity markets and interest rates and widespread economic uncertainty. Government interest rates fell to historic lows in the US, global credit spreads widened to historic levels, and credit markets seized up reducing liquidity. These factors had a significant adverse effect on Prudential's business and profitability during that period. Although global markets partially stabilized in 2009 and 2010, interest rates remain low, and many of the challenges of 2008 persist in the credit markets. New challenges 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 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.

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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 unforeseen market circumstances where the derivatives that it enters into to hedge its market risks may not fully offset its losses, and any cost of the guarantees that remain unhedged will also affect 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.

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

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

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

Due to their geographical diversity, Prudential's businesses are subject to the risk of exchange rate fluctuations. Prudential's operations in the US and Asia, which represent a significant proportion of operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements upon

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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, 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 somewhat higher amount of regulatory capital at the group level than otherwise necessary in respect of some of its individual businesses to accommodate, for example, short-term movements in global foreign exchange rates, interest rates, deterioration in credit quality and equity markets. The EU is also developing a new solvency framework for insurance companies, referred to as "Solvency II". The new approach will be based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessment of risk, and enhanced disclosure requirements – and will cover valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements. A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies, and may allow 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 a meeting of the EU's Economic and Financial Affairs Council on November 10, 2009. The European Commission is in the process of consulting on the detailed rules that will complement the high-level Principles of the Directive, referred to as "implementing measures", which are not expected to be finalized until late 2011. There is a significant uncertainty regarding the final outcome of this process. As a result there is a risk that the effect of the measures finally adopted could be adverse for Prudential, including potentially a significant increase in capital required to support its business.

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 has published an Exposure Draft for its Phase II on

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insurance accounting, which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts according to IFRS. The IASB has indicated a target date of June 2011 for issuing a final standard but it remains uncertain whether and how the proposals in the Exposure Draft will become definitive IFRS and when such changes might take effect.

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

European Embedded Value ("EEV") basis results are published as supplementary information by Prudential using principles issued by the European CFO (Chief Financial Officers) Forum. The EEV basis is a value-based reporting method for Prudential's long-term business which is used by market analysts and which underpins a significant part of the key performance indicators used by Prudential's management for both internal and external reporting purposes. In June 2008, in an effort to improve the consistency and transparency of embedded value reporting, the CFO Forum published the Market Consistent Embedded Value ("MCEV") Principles. Following a review of the impact of turbulent market conditions on the MCEV Principles, the CFO Forum announced in May 2009 the postponement of the mandatory reporting on an MCEV basis to December 31, 2011 and subsequently, in October 2009, changes in the principles to allow for the inclusion of a liquidity premium, which is the additional return investors require for investing in less liquid assets and is a key component in the calculation of the profitability of UK annuity business. It also announced that it was performing further work to develop more detailed application guidance to increase consistency going forward. When the work has been completed, Prudential will consider its approach to the new Principles. The adoption of the new Principles would give rise to different embedded value results from those prepared under the application of European Embedded Value Principles. In April 2011, the CFO Forum withdrew the intention that the MCEV principles be the only recognized format of embedded value reporting from December 31, 2011. The withdrawal reflects the ongoing development of insurance reporting under Solvency II and IFRS.

***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 particularly, but not exclusively, in the US and the UK are moving towards a regime based on principles-based regulation which brings an element of uncertainty. These regulators are increasingly interested in the approach that product providers use to select third party distributors and to monitor the appropriateness of sales made by them. In some cases, product providers can be held responsible for the deficiencies of third-party distributors.

In the US, federal and state regulators have focused on, and continue to devote substantial attention to, the mutual fund, fixed index 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.

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

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

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

The markets for financial services in the UK, US and Asia are highly competitive, with several factors affecting Prudential's ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, developing demographic trends and customer appetite for certain savings products. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates or claims-paying ratios. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential's potential to grow its business as quickly as planned.

In Asia, the Group's principal regional competitors 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 organizations, banks and other financial services companies such as AIG, AXA Financial Inc., Hartford Life Inc., 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 and retain current policyholders. In addition, the



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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;

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 long-term fund is rated Aa2 by Moody's, AA by Standard & Poor's and AA by Fitch;

Jackson's financial strength is rated AA by Standard & Poor's and Fitch, A1 by Moody's, and A+ by AM Best.

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

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

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

Further, because of the long-term nature of much of the Group's business, accurate records have to be maintained for significant periods. Prudential's systems and processes incorporate controls which are designed to manage and mitigate the operational risks associated with its activities. For example, any weakness in the administration systems or actuarial reserving processes could have an impact on its results of operations during the effective period. Prudential has not experienced or identified any operational risks in its systems or processes during 2010, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

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

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

A further example is the assumption that Prudential makes about future expected levels of the rates of early termination of products by its customers (persistency). This is particularly relevant to its lines of business other than its UK annuity business. Prudential's persistency assumptions reflect recent past

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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 organizations, in combating the spread and severity of any epidemics could have a material impact on the Group's loss experience.

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

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

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

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

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

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

*Prudential's Articles of Association contain an exclusive jurisdiction provision*

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

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*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 interpretation could affect Prudential's profitability and ability to provide returns to shareholders or alter the post-tax returns to shareholders.

**FORWARD-LOOKING STATEMENTS**

This annual report on Form 20-F may contain certain "forward-looking statements" with respect to certain of Prudential's plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates and projections, 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, fluctuations in interest rates and exchange rates, 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, 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 or accounting standards, 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 heading "Risk factors" in this section of this annual report and under the heading "Risk Factors" of Prudential's most recent Annual Report, as well as under the heading "Risk factors" in any subsequent Prudential Half Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K or filed in the UK. This annual report on Form 20-F, as well as Prudential's Annual Report and any subsequent Half Year Financial Report are/will be available on the Company's website at [www.prudential.co.uk](http://www.prudential.co.uk).

Any forward-looking statements contained in this report are made only as of the date hereof. Prudential may also make or disclose written and/or oral forward-looking statements in reports filed or furnished to the US Securities and Exchange Commission, as well as in its annual report and accounts to shareholders, proxy statements, offering circulars, registration statements and prospectuses, press releases and other written materials and in oral statements made by directors, officers or employees of Prudential to third parties, including financial analysts. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed in this Item 3 "Risk Factors" of this annual report on Form 20-F. These risk 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 undertakes no obligation to update the forward-looking statements contained in this statement or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the Prospectus Rules, the Listing Rules, the Disclosure and Transparency Rules, the Hong Kong Listing Rules, or the SGX-ST listing rules.

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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 market and, beginning in 2010, Prudential also publishes in the 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 categorized as single premiums and annual regular premiums. New business results are also summarized 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. As from the first quarter of 2010, 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**

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 over 25 million customers and has £340 billion in assets under management (as at December 31, 2010). 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, 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's core business is life insurance, health and protection, either attached to a life policy or on a standalone basis, and mutual funds. It also provides selected personal lines property and casualty insurance, group insurance, institutional fund management and consumer finance (Vietnam only). The product range offered is tailored to suit the individual country markets. Insurance products are distributed mainly through an agency 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 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 December 31, 2010, Prudential Corporation Asia had:

over 15 million customers in 28 businesses spread across 13 countries;

distribution relationships with over 75 institutions across Asia including Standard Chartered Bank (SCB), United Overseas Bank Limited (UOB), E-Sun Bank and joint venture partners ICICI in India and CITIC in China;

one of the largest networks of tied agents, comprising over 320,000 agents; 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 Hong Kong, India, Indonesia, Malaysia, Singapore, the Philippines and Vietnam.

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

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

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As at December 31, 2010, in the United States, Jackson:

was among the 20 largest life insurance companies in terms of General Account assets<sup>(1)</sup>;

was ranked 3<sup>rd</sup> in total annuity sales in 2010, up from 4<sup>th</sup> in 2009<sup>(2)</sup>;

was awarded the "Highest Customer Satisfaction by Industry" award from Service Quality Measurement Group<sup>(3)</sup>;

was once again rated as a "World Class" service provider for the fifth successive year by Service Quality Measurement Group<sup>(3)</sup>; and

completed another record sales year with total annual premium equivalent ("APE") retail sales of £1,164 million, the highest level in Jackson history.

In the United Kingdom, Prudential 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 banks and other financial institutions, and direct marketing, by telephone, mail, internet and face-to-face advisers.

As at December 31, 2010, Prudential in the United Kingdom:

was one of the market leaders in the individual annuity market and the with-profits market<sup>(5)</sup>;

managed total company assets of £145 billion, comprising £85 billion within the with-profits sub fund, £50 billion within shareholder-backed business and £10 billion in the Scottish Amicable Insurance Fund; and

M&G's retail business was awarded the prestigious 2010 Global Group of the Year award at the 15<sup>th</sup> annual Investment Week Fund Manager of the Year Awards for the second time in three years. M&G's institutional business was also recognized for its investment performance, winning the 2010 UK Asset Management Firm of the Year award at the Financial News' Awards for Excellence in Institutional Asset Management.

### **Group Strategy Overview**

At the centre of Prudential's strategy is the acceleration of its profitable growth in Asia, which offers many of the highest growth and return opportunities. The emerging markets of South-East Asia such as Indonesia, Malaysia, Vietnam, the Philippines and Thailand, together with Hong Kong and Singapore are particularly attractive. They remain the priority destination for Prudential's new capital investment. With Prudential's compelling platform of distribution, brand and product development capabilities in the high growth markets of Asia, Prudential believes it is particularly well positioned to take advantage of the considerable opportunity that the region offers.

In the US, Prudential continues to build on the strength of its operations to make them a more significant component of the Group in terms of IFRS earnings as well as cash generation. In the UK, Prudential remains focused on generating cash and capital and providing resilience to the Group's balance sheet.

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(1) Source: Statutory financial data per National Underwriter Insurance Data Services from Highline Data, rankings as of December 31, 2010, latest rankings available

(2)  
Source: Life Insurance and Market Research Association

(3)  
Source: Service Quality Measurement Group

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

(5)  
Source: Morningstar

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In asset management, Prudential's strong track record, both at M&G and in its asset management business in Asia, is enabling Prudential to grow its funds under management. These businesses make an increasingly important contribution to Prudential's profits and cash generation.

Each part of the Group plays a key role in Prudential's strategy. Prudential's flexibility and diversification were instrumental in allowing it to navigate successfully the economic and market cycle in 2008 and 2009.

In executing this strategy, Prudential is guided by three clearly-defined Group wide operating principles. The first of these is that from 2008, Prudential decided to take a more balanced approach to performance management across the three key measures of Embedded Value (EEV), IFRS and cash, with an increased emphasis on IFRS and cash. Second, Prudential has focused on allocating capital with total discipline to the highest return and shortest payback opportunities across the Group. This means that Prudential restricts new business to areas of the market where these stringent criteria are met. Finally, Prudential's third operating principle of equal importance is to take a proactive approach to managing risk across the cycle.

**2011 Priorities**

Prudential aims to focus on the following priorities in 2011:

***Group***

Continue to implement strategy with discipline, allocating capital to the most attractive markets and products

Manage risk and capital prudently, but proactively

Focus on delivering a progressive dividend, determined after taking into account the Group's financial flexibility and opportunities to invest in areas of business offering attractive returns

***Life insurance***

In Asia:

Continue expanding multi-channel distribution platform and improving its productivity

Focus on regular premium products with comprehensive suite of protection riders

Drive value through operational efficiency

In the US:

Continue to drive positive net retail sales

Innovate around Jackson's key variable annuity product

Further enhance operational efficiency

In the UK:



## Edgar Filing: PRUDENTIAL PLC - Form 20-F

Balance writing profitable new business at attractive returns on capital with sustainable cash generation and capital preservation.

Continue to pursue a value-driven strategy built around our core strengths in with-profits and annuities

Deliver further improvements to operational performance and customer service while maintaining our strict focus on costs.

Continue building complementary distribution channels.

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*Asset management*

Maintain superior long-term investment performance for both internal and external funds

Continue growth in third-party retail and institutional businesses

**2013 Financial Objectives**

*The following discussion contains forward-looking statements that involve inherent risks and uncertainties. Prudential's actual future financial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement due to a number of important factors (including those discussed under 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 normalized economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the half-year ended June 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II, which remains uncertain.*

In December 2010, Prudential announced new objectives for the Group that reflect its determination to accelerate growth in Asia and its belief that it can continue to deliver both growth and cash sustainably to its shareholders.

Its core objectives are:

- (i) In Asia, to double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: £465 million) and to double the 2009 value of EEV new business profits in 2013 (2009: £713 million).
- (ii) For each business unit to remit net cash to the Group: Asia to deliver £300 million of net cash remittance to the Group in 2013 (2009: £40 million); Jackson to deliver £200 million of net cash remittance to the Group in 2013 (2009: £39 million); UK to deliver £350 million of net cash remittance to the Group in 2013 (2009: £284 million<sup>(1)</sup>).
- (iii) 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<sup>(2)</sup> generation of £6.5 billion over the same period.

These objectives reflect Prudential's goal of providing through strategy and disciplined execution both growth and cash to its shareholders at a sustained pace.

**Summary**

Prudential reported a very strong performance in 2010, with results significantly ahead of 2009 achieved by remaining focused on rigorous capital allocation and effective management of its balance sheet.

These principles have served Prudential well during the financial crisis allowing it to emerge from the 2008-2009 period with a stronger balance sheet, higher profits, higher cash flows and an increased dividend. Prudential believes that its 2010 results support its view that its current strategy, underpinned by its operating principles, should increasingly allow it to differentiate itself through its ability to combine growth and cash generation.

- 
- (1) Representing the underlying remittances excluding the £150 million impact of pro-active financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

- (2)

Free surplus for the insurance business represents 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.

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Prudential's aim across all of its businesses is to develop and market a suite of products that deliver good value solutions that meet its customers' needs, in a way that is profitable and capital efficient for the Group.

In 2010, Prudential announced an agreement with AIG to acquire its Asia operations, AIA. The proposed acquisition was a unique opportunity to accelerate Prudential's strategy of focusing on the fast growing markets in Asia. Prudential could not agree a purchase price that was acceptable to the AIG Board. The costs associated with the transaction are detailed in note B1 to the consolidated financial statements in Item 18 of this annual report.

Prudential believes that its financial performance in Asia will continue to be based on three principal drivers. First, as a result of its strong new business growth, and its contribution to the increase in its in-force policies book, net inflows in Prudential's Asian businesses are expected to be a major contributor to its IFRS earnings. Second, it is expected that there will continue to be a contribution from investment returns, which are expected to increase as the business grows. Third, as the scale of the business increases, the Group's profitability is expected to continue to benefit from the efficiency of its Asian platform, with expected revenues growing faster than expected cost base.

In the US, Prudential has maintained its focus on value over sales volume growth, ensuring sales are delivered at highly profitable margin levels. Prudential has maintained its pricing discipline and has been consistent in its approach of not chasing market share for its own sake. In 2010 Prudential continued to benefit from the market changes following the financial turmoil in 2008 and 2009. As part of a trend, mostly driven by distributors who guide their customers towards the companies that held firm through the crisis and never closed to business, Jackson has significantly improved its position in the key variable annuity market. This flight to quality has allowed the Jackson team to increase sales volumes and market share.

Prudential's business in the UK in 2010 remained highly disciplined and generated differentiated returns relative to the market. Prudential continued to be a market leader in both individual annuities and with-profits business. Prudential maintained its focus on balancing the writing of new business with the generation of cash and capital, successfully delivering attractive returns on capital employed. Prudential's emphasis on value and generating strong returns saw the UK business continue to prioritize the retail market, while selectively participating in the wholesale market.

M&G had a very good 2010, a performance which is all the more impressive as it comes after an exceptional year in 2009. M&G continues to focus on offering customers superior investment performance over the longer term, building on its proven track record of success in the retail investment market through ongoing expansion in Europe and the innovative range of specialist fixed income strategies, including leveraged finance and infrastructure investment, that are offered in the institutional market.

In Asia, Prudential's asset management business also had a very successful year. It is a key feature of Prudential's strategy that asset management profits are very capital efficient and are "cash rich" profits. In 2010, Prudential appointed a new Chief Executive for the Asian asset management business, and is determined to continue to invest to capture a significant share of the growth and profits available in asset management in Asia.

**Company Address and Agent**

Prudential plc is a public limited company incorporated on November 1, 1978, and organized under the laws of England and Wales. 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.

Table of Contents**Significant Subsidiaries**

The table below sets forth Prudential's significant subsidiaries.

<b>Name of Company</b>	<b>Percentage Owned(1)</b>	<b>Country of Incorporation</b>
The Prudential Assurance Company Limited	100%	England and Wales
Prudential Annuities Limited <sup>(2)</sup>	100%	England and Wales
Prudential Retirement Income Limited <sup>(2)</sup>	100%	Scotland
M&G Investment Management Limited <sup>(2)</sup>	100%	England and Wales
Jackson National Life Insurance Company <sup>(2)</sup>	100%	United States
Prudential Assurance Company Singapore (Pte) Limited <sup>(2)</sup>	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.

**Asian Business****Life Insurance****Market Overview**

Overall, Asia's life insurance industry saw a sharp recovery in new business volumes during 2010 as markets moved beyond the 2008/2009 crisis.

The competitive landscape for the life sector varies by market but has largely remained consistent with that seen in prior years. Most markets feature a mix of local and multinational players whose definitions of business success may differ.

Competition is primarily around securing distribution. With insurance penetration rates being generally low, growth is less constrained by the size of the market than by companies' ability to further expand it by adding distribution and making their products available to parts of the population who have never used them. A large proportion of sales in markets with low penetration are to consumers who have never bought a policy before, thus expanding the market itself.

Tied agency continues to dominate although distribution through banks is becoming increasingly significant, with examples like HSBC Life and Bank of China Life in Hong Kong. Across the region there is little direct competition on products; there are no patents or copyrights in life insurance, or on product pricing, where regulators typically define the parameters for the industry.

The region's life insurance regulators tend to adopt a conservative stance and remain focused on driving development of the sector in a way that balances the need to ensure consumers have, first and foremost, access to appropriate products that are sold in a fair and transparent manner with the need to reward shareholders for taking on the risks of investing in the development of a relatively young and capital intensive industry. The industry also employs millions of people in the region, an important consideration when high unemployment rates can be a catalyst for political friction. India saw regulatory change with the most impact during 2010, which in summary, was designed to shift the emphasis of the industry away from products which are mostly investment orientated and encourage more traditional savings and protection.

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A positive development in a number of markets has been the development of the financial press. Many leading publications carry regular sections on personal financial planning and there is healthy debate on the uses of particular types of product.

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***Introduction***

The overarching objective for Prudential in Asia is to continue building scale profitably, leveraging its advantaged platform. The strategic priorities articulated in 2006 remain entirely relevant and continue to be driven in a highly focused and disciplined way. While market outperformance in terms of new business growth is an indicator of scale, Prudential does not pursue volume for its own sake as Prudential puts profitability, returns on capital and capital efficiency ahead of topline growth.

Prudential currently insures over 11 million life customers in Asia and has 15 million in force policies. Highlighting the value Prudential policies have for its customers, Prudential paid out £2.6 billion in claims and maturities during 2010. This customer base is a tremendously valuable asset as a high proportion of new business came from existing customers in 2010 (excluding India). This reflects Prudential's enduring relationship with its customers and how its solutions are meeting their needs over time. The customer retention rate continues to improve and at 91 per cent it is one per cent up on 2009.

On February 1, 2010, Prudential acquired from United Overseas Bank (UOB) its 100 per cent interest in UOB Life Assurance Limited in Singapore for total cash consideration of SGD495 million (£220 million). As part of the transaction the Group also entered into a long-term strategic partnership to develop a major regional bancassurance business with UOB.

PCA Life Japan ceased writing new business with effect from February 15, 2010. This decision will be reviewed on an ongoing basis in the light of changes to the business environment. Prudential reinforced its commitment to honoring all existing policyholder contracts and providing policyholders with an appropriate level of customer service. Measures have been taken to ensure there is adequate staff and supporting infrastructure for customer servicing, taking into account that the company closed its proprietary distribution channel in 2006 and since then has been working with third party distributors only.

In June 2009, Prudential sold the assets and liabilities of its agency distribution and its agency force in Taiwan to China Life Insurance Company Ltd of Taiwan. Prudential remains an active and committed player in the Taiwanese life insurance market through its successful bancassurance, direct marketing and other non-agency distribution channels.

***Distribution***

One of the key components of Prudential's Asia strategy is driving agency distribution scale and productivity. Its agency structures are differentiated by market depending upon their size and maturity with the management emphasis balanced between recruitment (newer markets like Indonesia and Vietnam) and productivity growth (more established markets like Hong Kong and Singapore). However this is a simplification as those two priorities are always present and not mutually exclusive; local management will always focus on both.

Prudential's agency management competencies drive effective selection discipline and training designed to "fast start" new agents and improve the skills and productivity of the more experienced ones. The combination of training programs, comprehensive product suites, specialized support allowing agents to address the evolving needs of existing customers and technology solutions to facilitate the fact finding and proposal submission processes combine to add value to agents, shareholders and customers.

During 2010 total average agent numbers excluding India at 154,000 were up 7.5 per cent over 2009. In India, where significant regulatory changes were introduced during the year, agent numbers were down 27 per cent to 168,000 at the end of December 2010. This is in line with the strategy to rationalize expense levels and focus on productivity improvements, which puts Prudential in a strong position to respond to the recent regulatory changes.

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Prudential is a pioneer and regional leader in partnership distribution in Asia. Key success drivers are its expertise in developing, training and motivating in branch insurance specialists and the investment in enduring and mutually beneficial relationships with partners, including Standard Chartered Bank across the region, E.Sun in Taiwan and most recently United Overseas Bank (UOB) in Singapore, Thailand and Indonesia. In April 2011, Prudential extended its distribution arrangement with UOB to include Malaysia.

***Products***

The life insurance products offered by Prudential include a range of with-profits (participating) and non-participating term, whole life endowment and unit-linked policies. Prudential also offers health, disablement, critical illness and accident cover to supplement its core life products. Prudential's Asian product mix in 2010 continued its emphasis on regular premium policies and protection riders. The high proportion of health and protection, standalone and riders, supports the new business profitability and reflects the higher proportion of risk based products in its book than some competitors who focus on single premium investment orientated policies.

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

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

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

Critical factors in 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 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, known as Takaful. The main principles are that policyholders co-operate among themselves for the common good, uncertainty is eliminated in respect of subscription and compensation and there is no investment in prohibited areas such as gambling or alcohol.



Table of Contents***New Business Premiums***

In 2010, total sales of insurance products, excluding Japan, were £2,495 million, up 30 per cent from 2009 (£1,916 million). Of this amount, regular premium insurance sales increased 23 per cent to £1,391 million and single premium insurance sales increased 41 per cent to £1,104 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.

<b>Single premiums</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Singapore	<b>318</b>	297	341
Hong Kong	<b>107</b>	94	507
Malaysia	<b>58</b>	63	28
Taiwan (excluding Taiwan agency)	<b>146</b>	104	36
Korea	<b>66</b>	38	78
China (Prudential's 50% interest in joint venture with CITIC)	<b>103</b>	72	63
Indonesia	<b>141</b>	41	94
India (Prudential's 26% interest in joint venture with ICICI)	<b>85</b>	47	60
Other countries	<b>80</b>	29	18
<b>Total excluding Japan</b>	<b>1,104</b>	785	1,225
Japan	<b>13</b>	57	115
<b>Total including Japan</b>	<b>1,117</b>	842	1,340

<b>Regular premiums</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Singapore	<b>143</b>	98	78
Hong Kong	<b>276</b>	232	154
Malaysia	<b>198</b>	140	99
Taiwan (excluding Taiwan agency)	<b>105</b>	97	55
Korea	<b>89</b>	118	211
China (Prudential's 50% interest in joint venture with CITIC)	<b>48</b>	38	32
Indonesia	<b>269</b>	186	167
India (Prudential's 26% interest in joint venture with ICICI)	<b>180</b>	163	202
Other countries	<b>83</b>	59	54
<b>Total excluding Japan</b>	<b>1,391</b>	1,131	1,052
Japan	<b>6</b>	46	30
<b>Total including Japan</b>	<b>1,397</b>	1,177	1,082

	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Total excluding			
Japan	<b>2,495</b>	1,916	2,277
Japan	<b>19</b>	103	145
Total including			
Japan	<b>2,514</b>	2,019	2,422

#### **Asset Management**

Prudential's asset management business in Asia manages investments for UK insurance operations and the Asian life companies and has also successfully leveraged these investment capabilities to build a strategically significant and market leading third party funds management business.

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Under the leadership of a new Chief Executive, the team has driven strong improvements in the business. The priorities for Prudential's asset management business in Asia are: to build and develop institutional relationships, securing pan-Asia discretionary mandates; to increase its focus on Japan and China, as the region's largest and fastest growing markets respectively; and, finally, to grow its offshore funds business.

Prudential's Asian asset management business' total funds under management (FUM) crossed the £50 billion mark for the first time and closed the year at £52 billion, which includes a core £25 billion from Prudential Corporation Asia's life funds, £5 billion of assets from the Group and £22 billion from third-party customers. Compared to 2009, the overall FUM increased by 22 per cent, driven by net inflows of £1.8 billion and a total of £7.7 billion of positive market and currency related movements.

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 dominate 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.

***Distribution***

In order to capitalize on the exciting and sizeable opportunities in Asia's retail financial services market, Prudential's Asian asset management business maintained its focus on building a strong third-party customer retail franchise. The customer proposition is driven by Prudential's strong investment capabilities, which enable it to develop innovative product suites, and distribute them through diverse channels including regional banks, local banks, private banks, and securities houses and an internal sales force. Prudential's Asian asset management business has become one of the largest and most successful domestic asset management companies in the region, as demonstrated by the fact that Prudential occupies a number of top ten market share positions in the markets in which it operates and the fact that a significant proportion of its funds are either in the top-two quartiles or outperformed their benchmarks over a three year period ended December 31, 2010.

***Products***

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

The business has been actively implementing its strategy of targeting higher-margin equity and bond asset classes. Third party net inflows of £1.8 billion were driven predominantly by Japan, which saw strong interest for its white-labeled Asia Oceanic High Dividend Equity and its open-ended Indonesian Equity Open funds. In addition, positive bond fund flows resulted from Taiwan and China's successful new product launches and strong demand for its offshore product range. Money market funds saw net outflows totaling £2.1 billion in 2010, mainly attributed to redemptions in India as a result of tighter liquidity conditions.

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

**US Business**

Prudential conducts its US insurance operations through Jackson and its subsidiaries, including Curian Capital, LLC, a registered investment adviser. The US operations also include PPM America, Prudential's US internal and institutional fund manager, and Prudential's US broker-dealer operations

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(National Planning Corporation, SII Investments, Inc., INVEST Financial Corporation and Investment Centers of America, Inc.). At December 31, 2010, Prudential's US operations had more than 2.8 million policies and contracts in effect and PPM America managed approximately £54 billion of assets. In 2010, new business premiums totaled a record £11,439 million.

**Jackson National Life Insurance Company**

Jackson is a leading provider of retirement income and savings solutions in the mass and mass-affluent segments of the US market, primarily to those planning for retirement or in retirement already. It offers tools that help people plan for their retirement, and offers products with specialized features and guarantees to meet customers' needs. By seeking to add value to both the representatives who sell Jackson products, and to their customers, Jackson has built a strong position in the US retirement savings and income market with a more than thirteen-fold increase in variable annuity sales from 2001 to 2010. Over the same period, Jackson improved its total annuity market share from 2.3 per cent in 2001 to 8.0 per cent in 2010 and moved from 17th in total annuity sales to 3rd.<sup>(1)</sup>

(1)

Source: Life Insurance and Market Research Association

During 2010, Jackson continued to be innovative in its product offerings, implementing various changes to increase sales, to comply with revised regulations or to enhance risk management flexibility and/or increase profitability. In 2010, Jackson added two new optional lifetime guaranteed minimum withdrawal benefits (GMWBs) to its variable annuity products. LifeGuard Freedom 6 Net GMWB, introduced in May, gives investors the opportunity to help offset their tax liability by increasing their available withdrawal amounts to generate more income. LifeGuard Freedom Flex, introduced in October, is the industry's first customizable guaranteed minimum withdrawal benefit. Freedom Flex extends the menu-driven construction that Jackson offers in its variable annuity products, which gives investors the ability to build a personalized benefit based on their individual retirement planning objectives, while paying only for those options elected. Additionally, Jackson added six portfolios from American Funds and added BlackRock, managing two portfolios, to its variable annuity fund line-up during the year.

Jackson's strategy continues to focus on balancing volume and capital consumption for both variable and fixed annuities. Jackson did not sell any institutional products during 2010, as available capital was directed to support higher-margin variable annuity sales.

The significant increase in new business during 2010, as a result of the continuing improvement in the equity markets, resulted in higher call volumes to Jackson's service centers. As a result, workloads continued to rise. Jackson continues to invest in its back office staffing and systems to provide world class customer service in an efficient and cost effective manner. In 2010, for the fifth consecutive year, Jackson was rated "World Class" service provider by Service Quality Measurement Group's ("SQM"), for its Michigan call centre in the SQM's latest benchmarking study of North American service centers. Historically, this World Class designation is earned by only five per cent of service centers. Furthermore, 2010 marked the sixth year that Jackson has achieved a World Class designation for customer service. Jackson was able to provide this level of service in 2010 while processing record retail sales and maintaining its ratio of statutory general expenses to average assets (one measure of efficiency) at the 2009 level of 44 basis points. Jackson also earned SQM's "Highest Customer Satisfaction by Industry" award for having the highest rate of customer satisfaction in the financial services industry.

With consistent, high-quality wholesaling support and customer service, combined with stability in product offering, pricing and financial strength ratings and the ability to bring new products to market swiftly, Jackson continues to be an attractive business partner for its long-term distributors, as well as attract new distributors. During 2010, Jackson increased the number of licensed agents and registered representatives to more than 130,000.

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

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Centers of America, Inc, National Planning Corporation and SII Investments, Inc. By utilizing 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.

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
<b>By Product</b>			
Annuities			
Fixed annuities			
Interest-sensitive	755	915	1,629
Fixed index	1,089	1,433	501
Immediate	81	138	95
Variable annuities	9,481	6,389	3,491
<b>Total</b>	<b>11,406</b>	<b>8,875</b>	<b>5,716</b>
Life insurance	33	34	31
Institutional products			
GICs, funding agreements and Federal Home Loan Bank of Indianapolis (FHLBI) advances			560
Medium term note funding agreements			634
<b>Total</b>			<b>1,194</b>
<b>Total</b>	<b>11,439</b>	<b>8,909</b>	<b>6,941</b>
<b>By Distribution Channel</b>			
Independent agents	846	1,229	1,225
Bank	2,285	1,566	1,077
Independent broker-dealer	6,503	5,062	2,927
Regional broker-dealer	1,789	1,037	501
Captive agents	16	15	16
Institutional products department			1,195
<b>Total</b>	<b>11,439</b>	<b>8,909</b>	<b>6,941</b>

Of the total new business premiums of £11,439 million in 2010 (2009:£8,909 million; 2008:£6,941 million), £11,417 million (2009: £8,885 million; 2008: £6,917 million) were single premiums and £22 million (2009: £24 million; 2008: £24 million) were regular premiums.



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*Annuities*

*Fixed Annuities*

*Interest-sensitive Annuities*

In 2010, interest-sensitive fixed annuities accounted for seven per cent of total new business premiums and 19 per cent of policyholder liabilities of the US operations. These annuities, which allow for tax-deferred accumulation of funds, are used for asset accumulation in retirement planning and for providing income in retirement and offer flexible payout options. The contract holder pays Jackson a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and administrative charges are deducted, as appropriate. On more than 88 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.

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

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

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

Approximately 45 per cent of the interest-sensitive fixed annuities Jackson wrote in 2010 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 realize as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment.

*Fixed Index Annuities*

Fixed index annuities accounted for 10 per cent of total new business premiums in 2010 and nine per cent of policyholder liabilities of the US operations. Fixed index annuities are similar to fixed annuities in that the contract holder pays Jackson a premium, which is credited to the contract holder's account, and periodically, interest is credited to the contract holder's account and administrative charges are deducted, as appropriate. Jackson guarantees an annual minimum interest rate, although actual interest credited may be higher and is linked to an equity index over its indexed option period.

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

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

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*Immediate Annuities*

In 2010, immediate annuities accounted for less than one per cent of total new business premiums and two per cent of policyholder liabilities of the US operations. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years and/or the life of the policyholder. If the term is for the life of the policyholder, then Jackson's primary risk is mortality risk. This product is generally used to provide a guaranteed amount of income for policyholders and is used both in planning for retirement and in retirement itself. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

*Variable Annuities*

In 2010, variable annuities accounted for 83 per cent of total new business premiums and 58 per cent of policyholder liabilities of the US operations. Variable annuities are tax-advantaged deferred annuities where the rate of return depends upon the performance of the underlying portfolio, similar in principle to UK unit-linked products. They are also used for asset accumulation in retirement planning and to provide income in retirement.

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

Jackson offers a choice of guaranteed benefit options within its variable annuity product portfolio, which customers can elect and pay for. These include the guaranteed minimum death benefits ("GMDB"), which guarantees that, upon death of the annuitant, the contract holder or beneficiary receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the return of original premium, the highest past anniversary value of the contract, or as the original premium accumulated at a fixed rate of interest. In addition, there are three other types of guarantees: guaranteed minimum withdrawal benefits ("GMWB"), guaranteed minimum accumulation benefits ("GMAB") and guaranteed minimum income benefits ("GMIB"). GMWBs provide a guaranteed return of the principal invested by allowing for periodic withdrawals that are limited to a maximum percentage of the initial premium. One version of the GMWBs provides for a minimum annual withdrawal amount that is guaranteed for the contract holder's life without annuitization. GMABs generally provide a guarantee for a return of a certain amount of principal after a specified period. GMIBs provide for a minimum level of benefits upon annuitization regardless of the value of the investments underlying the contract at the time of annuitization. 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 guarantees.

In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilize 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 utilization of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure.



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Accounting volatility arises within Prudential's IFRS total profit due to the difference between the movement in the fair value of free standing derivatives within Jackson's equity annuity hedging program and the movement in the accounting value of Jackson's liabilities for variable and fixed index annuity guarantees. Typically, under IFRS, reserves are not fair valued, which for the US variable annuities business produces a distorting accounting effect on the IFRS total profit that is not representative of the true economics of Jackson's hedging program. Jackson's economically based hedges are marked to market. As a result, when the marked to market value of the hedges changes, there are offsetting changes in the economic value of the hedged liabilities which are not reflected in the accounts. This is particularly relevant for the GMDB and the GMWB with "for-life" features. This mismatch creates additional short-term variability in the IFRS total profit which does not reflect changes in the underlying economic position.

Assuming a set of reasonable long-term assumptions, the impact of this accounting distortion should cumulatively net out to a broadly neutral effect, but in the short-term, the IFRS total profit can be highly volatile. The recent growth in Jackson's variable annuity business had resulted in this short-term effect having a greater impact on the IFRS total profit than in prior years. In 2010, Prudential amended its presentation of this accounting mis-match within its supplementary analysis of profit before tax attributable to shareholders as described further in note A4d(ii) to Prudential's consolidated financial statements in Item 18.

***Life Insurance***

Reflecting the competitive life insurance market and the overall trend towards asset accumulation products, Jackson's life insurance products accounted for less than one per cent of the total new business premiums and seven per cent of policyholder liabilities of the US operations in 2010. Jackson sells several types of life insurance, including term life, universal life and variable universal life. Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a life insurance policy that combines death benefit protection and the important tax advantages of life insurance with the long-term growth potential of professionally managed investments. Jackson's life insurance book has delivered consistent profitability, driven primarily by positive mortality and persistency experience.

***Institutional Products***

Institutional products consist of traditional guaranteed investment contracts ("GICs"), funding agreements, including agreements issued in connection with participation in the Federal Home Loan Bank of Indianapolis ("FHLBI") mortgage-collateralized loan advance program, and medium term note funding agreements. The US operations sold no institutional products during 2010 and 2009, as available capital was directed to support higher-margin variable annuity sales. As at December 31, 2010, institutional products accounted for five per cent of policyholder liabilities of the US operations. The GICs are marketed by the institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its program.

***Traditional Guaranteed Investment Contracts***

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

Traditional GICs have a specified term, usually two to three years, and typically provide for phased payouts. Jackson tailors the scheduled payouts to meet the liquidity needs of the particular retirement

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plan. If deposited funds are withdrawn earlier than scheduled, an adjustment is made that approximates a market value adjustment.

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

Funding Agreements

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

Typically, brokerage accounts and money market mutual funds are required to invest a portion of their funds in cash or cash equivalents to ensure sufficient liquidity to meet their customers' requirements. The funding agreements permit termination by the policyholder on seven to 90 days notice, and thus qualify as cash equivalents for the clients' purposes. Funding agreements terminable by the policyholder with less than 90 days' notice account for less than one per cent of total policyholder reserves as at December 31, 2010.

Jackson is a member of the FHLBI. Membership allows Jackson access to advances from FHLBI that are collateralized 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.

**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, banks and registered investment advisors. Jackson also markets life insurance and fixed annuity products through its captive insurance agency, which is concentrated in the south eastern United States.

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

*Independent Agents and Broker-Dealers*

Jackson's subsidiary, Jackson National Life Distributors, LLC ("JNLD"), is the primary marketing and distribution organization for annuities and life insurance products. The insurance and fixed annuity products are distributed through independent agents located throughout the United States. These approximately 22,000 appointed insurance agents or brokers at December 31, 2010, who also may represent other companies, are supported with marketing materials and multi-media presentations to help advisers choose the right solutions for their clients' individual financial situations. JNLD generally

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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 December 31, 2010, Jackson had active selling agreements with independent broker-dealer organizations throughout the United States providing access to more than 51,000 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 customized materials and support to meet their specialized advisory needs.

Jackson's RBD team also provides support for the wirehouse channel, which produced £1.6 billion of premium in 2010. Jackson first entered the wirehouse market in late 2006.

Jackson's RBD team supports 25,000 representatives in regional broker-dealers and wirehouses.

***Banks, Credit Unions and Other Financial Institutions***

Jackson's Institutional Marketing Group distributes annuity and life insurance products through banks, credit unions and other financial institutions and through third-party marketing organizations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and at December 31, 2010 had access to more than 33,900 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 made up of four firms, National Planning Corporation, SII Investments, Inc., INVEST Financial Corporation and Investment Centers of America, Inc. NPH had 3,461 registered representatives at the end of 2010.

***Institutional Products Department***

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

***Captive Agency***

In connection with the acquisition of Life of Georgia in 2005, Jackson established the JNL Southeast Agency ("JNLSEA"), the company's first captive agency since 1970. JNLSEA, with more than 100 life insurance agents at December 31, 2010, was formed to help retain the Life of Georgia book of business and to create a new distribution channel for Jackson's life insurance.

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***Registered Investment Adviser***

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

The registered investment adviser industry began as a service offered to very high net worth investment clients, focusing on platforms rather than specific products, and providing institutional quality management, custom portfolios and tax services. The industry has evolved to offer personalized 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, totaled £1,361 million and £796 million in 2010 and 2009, 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 with the duration of the assets in its investment portfolio with the annuity, term life, whole life, universal life and guaranteed investment contract product obligations. Jackson seeks to achieve a target spread between what it earns on its assets and what it pays on its liabilities by investing principally in fixed-rate securities and in options and futures to hedge equity-related movements in the value of its products.

Jackson segregates its investment portfolio for certain investment management purposes, and as part of its overall investment strategy, into four portfolios: 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 December 31, 2010, eight 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 December 31, 2010, 73 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 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

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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 and the subsequent rebound 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 policyholder's account value. For the immediate annuities, reserves are determined as the present value of future policy benefits. Mortality assumptions are based on the 1983 Individual Annuitant Mortality Table and the Annuity 2000 Mortality Table for newer issues. Interest rate assumptions currently range from two per cent to seven 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 the net level premium method and 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 four 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 policyholder's account value.

**Reinsurance**

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

Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to obtain a greater diversification of risk for the life insurer. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured. Jackson's reinsured business is ceded to numerous unaffiliated reinsurers and the amount of 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.

Jackson limits the amount of risk it retains on new policies. Currently, the maximum risk that is retained on new policies is US\$2.0 million. Jackson is not a party to any risk reinsurance arrangement with any reinsurer pursuant to which the amount of reserves on reinsurance ceded to such reinsurer equaled more than one per cent of total policy reserves.

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Jackson typically cedes 90 per cent of new writings of level premium term products. Jackson intends to continue to cede a significant proportion of new term life insurance business for as long as pricing in the reinsurance markets remains favorable.

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 policyholders. Jackson's ability to implement new products quickly and provide customer service is supported by integrated computer systems that issue and administer complex life insurance and annuity contracts. Jackson continues to develop its life insurance administration and underwriting systems and its fixed and variable annuity administration systems to enhance the service capabilities for both new and existing policies.

**PPM America**

PPM America is Prudential's US fund management operation, with offices in Chicago and New York. PPM America manages assets for Prudential's US, UK and Asian affiliates. Its primary focus is to manage funds for Jackson and therefore the majority of funds under management are fixed interest in nature. PPM America also provides other affiliated and unaffiliated institutional clients with investment services, including collateralized debt obligations (CDOs), private equity funds, institutional accounts, and mutual funds.

**UK Business**

**Introduction**

As at December 31, 2010, 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 and M&G.

The following discussion describes:

the UK retail financial services market;

Prudential's UK business units, products and distribution channels;

Prudential UK's reinsurance arrangements and reserving practice; and

shareholders' participation in Prudential UK's long-term insurance business.

In 2010, Prudential's UK business generated new business insurance premiums of £5,910 million and gross investment inflows of £26,372 million. As at December 31, 2010, M&G had £198 billion of funds under management.

**Prudential UK business overview**

Prudential UK competes selectively in the UK's retirement savings and income market. The focus of the business is to balance writing profitable new business at attractive returns on capital with sustainable cash generation, which is key for the Group and capital preservation. It is this discipline that has enabled Prudential UK to deliver another strong performance in 2010.

The UK has a mature life and pensions market which is characterized by an ageing population in particular, through two waves of baby-boomers born after World War II and in the 1960s with wealth distribution significantly skewed and very much concentrated in the 45-74 age group. In this context, the retirement and near-retirement segments are highly attractive.



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UK consumers are insufficiently prepared as they will have to face increasingly long periods of retirement. This will result in longer working lives and a more flexible approach towards retirement. It will also mean that the baby-boomers will need to target their wealth on the provision of dependable retirement income. Prudential UK's expertise in areas such as longevity risk management and multi-asset investment, together with its financial strength and strong brand, mean that the business is strongly positioned in the retirement planning space with a particular focus on with-profits and annuities.

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

The strength and investment performance of Prudential UK's With-Profits Fund is widely recognized in the industry and was demonstrated by the 12.7 per cent pre-tax investment return achieved for policyholder asset shares in the Fund in 2010. The Fund has delivered investment returns of 82.1 per cent over ten years, which compares favorably with other with-profits funds and the FTSE All-Share Index (total return) of 43.3 per cent over the same period. This strong performance has shown that the with-profits type of business, when invested in an actively managed, and financially strong fund like Prudential's, continues to be a very attractive medium to long-term investment, offering strong annualized returns compared with other investment options. Prudential's with-profits customers benefit from the security offered by Prudential's large inherited estate, with the free assets of the with-profits fund valued at approximately £6.8 billion at the year-end, valued on a realistic basis.

In September 2010, Prudential UK announced a five-year exclusive agreement with Santander to distribute its market-leading investment bonds in the UK. Prudential UK's Flexible Investment Plan, including PruFund, will be available to Santander's UK customers in 1,300 high street branches throughout the country. This new agreement, which is expected to go live in the second half of 2011, forms part of Prudential UK's continuing strategy to develop diversified and complementary distribution across its Direct, Intermediary and Partnership channels.

Prudential UK's focus on delivering improved levels of customer service was recognized again at the 2010 Financial Adviser Service Awards, where it retained its 5-Star rating for excellent service in the Investment category.

The business met its cost savings target of £195 million per annum by June 2010, six months early. Prudential UK has commenced a number of cost saving initiatives to reduce costs by a further £75 million per annum on a consistent basis by the end of 2013. The business has already made good progress towards this objective in 2010.

**UK products and profitability**

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

With-profits policies are supported by a with-profits sub-fund and can be single premium (for example, Prudence Bond) or regular premium (for example, certain corporate pension products). Prudential UK's primary with-profits sub-fund is part of PAC's long-term fund. The return to shareholders on virtually all with-profits products is in the form of a statutory transfer to PAC shareholders' funds which is analogous to a dividend from PAC's long-term fund and is dependent upon the bonuses credited or declared on policies in that year. Prudential UK's with-profits policyholders currently receive 90 per cent of the distribution from the main with-profits sub-fund as bonus additions to their policies and shareholders receive the remaining 10 per cent as a statutory transfer.



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

The defined charge participating sub-fund ("DCPSF") forms part of PAC's long-term fund and comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into PAC from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and the with-profits annuity business transferred to PAC from the Equitable Life Assurance Society on December 31, 2007. All profits in this fund accrue to policyholders in the DCPSF.

**Products**

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

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

**Distribution**

Retail financial services and products are distributed face to face through bank branches, tied agents, company sales forces and financial advisers, or directly by mail, telephone and over the internet. Independent Financial Advisers dominate the intermediary marketplace and offer products from a range of insurance companies selected from the whole of the market. Tied agents are either "single tied" exclusive agents who represent only one insurer or "multi-tied"; advising on the products of a limited range of providers. Tied agents must offer customers the products most suitable to their needs, but only from the range of products offered by the insurers to which they are tied. Direct and e-commerce distribution methods are generally lower-cost than other methods but have not generally been conducive to providing financial advice to the consumer. Accordingly, products distributed directly are generally more straightforward and have lower charges.

The FSA's review of the retail distribution marketplace called the Retail Distribution Review ("RDR") culminated in a policy statement on March 26, 2010. The changes contained in the review are designed to encourage greater levels of transparency, professionalism and sustainability within the industry, with the prime aim of increasing consumers' confidence in the industry and therefore their desire to engage with it. Prudential supports the removal of commission payments, the introduction of adviser charging and the new professional standards and believes that these provide an opportunity to put in place a

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framework that will better align the interests of consumers, advisers and providers. The new rules reflecting these changes have been confirmed and will come into force on December 31, 2012.

The changes to be implemented improve the clarity with which firms describe their services to customers and the role of advisers, particularly with regards to remuneration. The advice market will be split between independent and restricted advice. This will be supported by the need for specific disclosure of status both in writing and orally at point of sale. Commission will be replaced by "Adviser Charging" with prescriptive rules aimed at ensuring consumers have total clarity on the cost of advice services. The changes will in particular significantly increase the requirements for firms to be able to describe themselves as independent. As a result it is widely expected that the popularity of restricted advice models will grow and that a return of provider-led direct to consumer advice models is therefore likely.

While the new rules apply to all retail investment advice, advisers will continue to be able to be remunerated by commission for pure protection business as the FSA believes that the focus on competitive premiums provides adequate controls. The FSA has, however, confirmed that similar rules to ban commission are to be implemented in the group pensions marketplace.

A significant feature of the UK retail marketplace over the past five years has been the emergence of investment platforms. From an initial concept of providing easy access by consumers and advisers to unwrapped investments 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.

As a result, in parallel to the overall RDR, the FSA has been paying specific attention to the role of platforms in the marketplace and in December 2010 published a consultation paper confirming their proposals for the integration of platforms into the overall RDR. The FSA has focused on ensuring that where investment rebates are paid by fund managers and product providers to platforms, these do not create investment bias and are fully transparent to consumers. In parallel, the FSA also confirmed its intention to ban rebates payable directly to consumer cash accounts as it believes that there is a significant risk that such payments would undermine the remuneration transparency which they are seeking.

The full impact of the RDR cannot yet be predicted. Some IFAs may choose to exit the market, whilst others may 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 third party distributors and a major bank. A large proportion of Prudential UK's annuity sales are made on a non-advised basis and will be unaffected by these changes.

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

As at December 31, 2010, Prudential UK distributes its products through the following channels:

	<b>Year Ended</b>		
	<b>December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>£ million</b>		
Direct & Partnerships	<b>1,915</b>	2,015	2,567
Intermediated	<b>2,937</b>	2,810	3,029
Wholesale	<b>945</b>	62	1,434
Sub-Total	<b>5,797</b>	4,887	7,030
DWP Rebates	<b>113</b>	127	153
Total New Business Premiums	<b>5,910</b>	5,014	7,183

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***Direct and Partnerships***

The direct distribution channel is primarily charged with increasing revenue from existing Prudential UK customers and with seeking new customers. Direct distribution channels include the telephone, mail and internet and focuses on annuities, investments, protection and health products. Partnerships focus on developing strong relationships with banks, retail brands and other distributors. Partnerships also seek to help the Prudential UK's distribution partners in their distribution and product development strategies. Prudential UK now has a range of distribution partners including Barclays, Royal London Mutual, Save and Prosper, Santander, St James's Place and Openwork.

***Intermediaries***

The focus in 2010 has been on continuing to win panel positions and strengthening relationships, which has resulted in a five per cent increase in sales through this channel.

***Wholesale***

In the Wholesale market, Prudential UK's aim is to continue to participate very selectively in bulk and back-book buyouts using its financial strength, superior investment track record and annuitant mortality risk assessment and servicing capabilities. Prudential UK maintains a strict focus on value and will only participate in transactions that meet its strict return on capital requirements. In line with this approach, in the fourth quarter of 2010, Prudential UK signed a bulk annuity buy-in insurance agreement of total new business premiums of £885 million.

**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 the 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,

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primarily investment bonds, in other European countries. The volume of such business is relatively small and is included in the table below.

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
<b>Life insurance</b>			
With-profits	<b>1,464</b>	1,320	968
Unit-linked	<b>562</b>	610	939
<b>Total life insurance</b>	<b>2,026</b>	1,930	1,907
<b>Pensions</b>			
With-profits individual	<b>150</b>	154	77
Unit-linked individual	<b>109</b>	89	93
Department of Work and Pensions rebates	<b>113</b>	127	153
Corporate	<b>426</b>	383	647
<b>Total pensions</b>	<b>798</b>	753	970
<b>Pension annuities and other retirement products</b>			
Fixed	<b>1,232</b>	1,445	2,427
Retail Price Index	<b>1,341</b>	493	1,404
With-profits	<b>501</b>	382	459
<b>Total pension annuities and other retirement products</b>	<b>3,074</b>	2,320	4,290
Healthcare	<b>12</b>	11	16
<b>Total new business premiums</b>	<b>5,910</b>	5,014	7,183

Of the total new business premiums of £5,910 million (2009: £5,014 million; 2008: £7,183 million), £5,656 million (2009: £4,768 million; 2008: £6,929 million) were single premiums and £254 million (2009: £246 million; 2008: £254 million) were regular premiums.

Life Insurance Products

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

Savings Products Investment Bonds

Prudential UK offers customers a range of investment funds to meet different risk and reward objectives. Prudential UK launched the Flexible Investment Plan ("FIP") in 2003 and the Prudential Investment Plan ("PIP") in 2007. Through these plans, which are single premium with no fixed term, customers have the option to invest in the With-Profits fund or in a range of unit-linked investment funds.

In January 2010, Prudential UK launched Dynamic Portfolios, which offer advisers a choice of portfolio options to match a client's risk/reward profile as an alternative to building an individual portfolio. Both FIP and PIP also give financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In 2010, sales of the unit-linked option of FIP and PIP were £188 million.

Prudential UK offers a unitized and smoothed with-profits investment bond entitled PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer. PruFund also offers clients an optional five-year guarantee on the initial investment. In 2008, PruFund



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became available as a fund option on the FIP and PIP products. In 2010, total new business premiums attributable to PruFund, including new business through FIP and PIP, was £1,140 million.

In March 2008, Prudential UK launched the International Portfolio Account ("IPA") offering clients access to a wide range of quoted UK investments. Sales of Prudential's offshore bonds, the International Prudence Bond, International Prudential Portfolio Bond and International Portfolio Account were £255 million in 2010.

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

Sales of PruFund remained strong in 2010. Since October 2008, PruFund has been available across Prudential UK's range of tax wrappers, including individual pensions, income drawdown and onshore and offshore bonds. Over £1.3 billion was invested across the Prudential UK retail savings product range in 2010. In 2009, Prudential UK extended further the PruFund range of investments with the launch of the PruFund Cautious series to sit alongside the PruFund Growth series within the on-shore bond wrapper. As at December 31, 2010, over £1.2 billion had been invested in PruFund Cautious since it was launched. Prudential also launched the new PruSelect range of unit-linked funds across its UK pensions and investments products in 2008, more than doubling the number of funds available.

The sales growth across Prudential UK's with-profits range has been achieved on the back of sustained strong investment performance in its Life Fund over a number of years, reflecting the benefits of its diversified investment policy. 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.

*Life and Health Protection*

Prudential UK has a joint venture with Discovery of South Africa which uses the Prudential brand and Discovery's expertise to build branded distribution and innovative product offerings in the private healthcare and protection markets. PruHealth was launched in October 2004 as a private medical insurance provider and PruProtect, launched in September 2007, follows the success of PruHealth by applying the Vitality points system. PruProtect's product is focused around a core philosophy of helping people become healthier while protecting and improving the quality of their lives.

In August 2010, Prudential UK's joint venture partner Discovery SA announced the completion of the acquisition of Standard Life Healthcare and its combination with the PruHealth business. As part of the transaction, Prudential UK reduced its shareholding in the combined PruHealth and PruProtect businesses from 50 per cent to 25 per cent of the enlarged group.

Pension Products

Prudential UK provides both individual and corporate pension products. In 2010 new business premiums totalled £259 million for individual pensions and £426 million for corporate pensions. 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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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 a portion to be taken as a tax-free lump sum. For draw down 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 draw down 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 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 Guaranteed Annuity Options ("GAOs") in 1987, but for a minority of corporate pension schemes GAOs still apply for new members. Current liabilities for this type of business make up less than 1 per cent of the with-profits sub-fund as at December 31, 2010.

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

*Individual Pensions*

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

Prudential UK offers 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.

Starting from 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 will have to be automatically enrolled in a pension scheme by their employer, who will be required to make contributions. These requirements will apply first to larger employers and will be rolled out gradually to medium-sized and smaller employers.

*Department of Work and Pensions Rebates ("DWP Rebate")*

Prudential UK also provides individual personal pension products through the DWP Rebate arrangement. Under this arrangement, individuals may elect to contract out of the UK's State Second Pension (referred to as "S2P") which was previously known as State Earnings Related Pension Scheme, administered by the UK Department of Work and Pensions. If an individual elects to contract out, then he or she will designate a pension provider, such as 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

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quarter of each year. The option to contract out will be removed from April 2012 and no further contributions will be received, although Prudential will continue to administer in-force policies.

*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 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 Additional Voluntary Contribution (AVC) arrangements. Prudential UK provides AVCs to 66 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 stabilize or reduce potential pension liabilities.

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

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

*Pension Annuities and other retirement products*

Prudential UK offers individual conventional immediate annuities that are either fixed or retail price indexed (referred to as "RPI"), where annuity payments are guaranteed from the outset, or with-profits annuities, where annuity payments are variable dependent on the investment performance of underlying assets. Prudential UK also offers products with an income drawdown option which allow customers greater flexibility in terms of the amount of income they take in retirement and the option to delay buying an annuity up to age 75. In 2010, Prudential UK sold £100 million of income drawdown products. A total of £2,049 million of individual annuities were sold in 2010. Of this total, £1,235 million were sold to existing Prudential UK customers with maturing pension policies. The other £814 million were sold to new customers, typically individuals with a pension maturing with another provider who chose Prudential UK to provide their annuity. Prudential UK also offers bulk annuities 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 strict return on capital requirements. In 2010, Prudential UK sold £925 million of bulk annuities.

Prudential UK's immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available



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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 2010, sales of RPI annuities were £1,341 million (including £919 million of bulk annuities). In 2010, sales of level and fixed increase annuities amounted to £1,232 million (including £6 million of bulk annuities and £57 million of unit-linked income drawdown products).

*With-profits Annuities*

Prudential UK's with-profits annuities combine the income features of annuity products with the investment smoothing features of with-profits products and enable policyholders to obtain equity-type returns over time. Through this product, Prudential UK brings its product development strengths to bear while also capitalising on people's need for protection from inflation through increasingly long periods of retirement. Prudential is one of only a few companies in the United Kingdom which are active in the with-profits annuities market and has been operating in this market since 1991. In 2010, Prudential UK's premiums for this business were £501 million (including £43 million of with-profits income drawdown products). Prudential UK is the market leader, with a new business market share of 78 per cent in 2010<sup>(1)</sup>.

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(1)

Source: ABI

In the first quarter of 2009, Prudential UK launched the new Income Choice Annuity which allows customers to choose an income between a defined maximum and minimum level, with the option of re-setting this every two years. It also provides an opportunity for pension income to grow based on the returns of the with-profits fund.

*Income Drawdown*

Given the UK's historic requirement for compulsory annuitization 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. Prudential UK launched an income drawdown option as a part of the Flexible Retirement Plan in late 2007 and achieved premiums of £100 million in 2010 compared to £91 million in the previous year for this and the existing product, the Flexible Income Retirement Account. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth.

*Lifetime Mortgage*

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

**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

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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**

PAC's with-profits fund is one of the largest and financially strongest in the UK, and continues to cover comfortably all of its regulatory solvency requirements. The fund is supported by a large inherited estate, with the free assets of the with-profits fund valued at approximately £6.8 billion<sup>(2)</sup> (as at December 31, 2010), valued on a realistic basis. This provides the working capital required to support the fund for the long-term benefit of current and future policyholders.

(2)

As estimated at March 8, 2011 and included in the consolidated financial statements.

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

The following table contains balances derived from unaudited information contained in underlying financial accounting systems and other management documents.

	<b>2010</b>	<b>2009</b>
	%	%
UK equities	26	25
International equities	13	12
Property	12	12
Fixed Interest	42	40
Cash and other asset classes	7	11
Total	<b>100</b>	100



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Despite a low interest rate environment and three consecutive years of market uncertainty, the with-profits sub-fund continued to perform strongly in 2010. The with-profits sub-fund has delivered investment returns of 82.1 per cent over ten years for policyholder asset shares in the fund, compared with the FTSE All-share index (total return) of 43.3 per cent over the same period (figures are to December 31, 2010, before tax and charges). These returns clearly demonstrate the value for policyholders of investing in PAC's financially strong, well-managed With-Profits Fund and the benefits that this style of more cautious investing can provide over the medium to long-term.

**Realistic Financial Strength Reporting**

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

This basis makes companies' financial health more transparent to policyholders, intermediaries and regulators alike, and enables more informed choices to be made by policyholders. The PAC long-term with-profits sub-fund is very strong with the inherited estate (free assets) measured on a realistic basis, valued at approximately £6.8 billion<sup>(2)</sup> at the end of 2010 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. For statutory and management purposes, PAC's long-term fund consists of a number of sub-funds in which shareholders and policyholders have varying interests.

***With-profits Products***

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

With-profits policies are supported by a with-profits fund. Prudential UK's primary with-profits fund is part of PAC's long-term fund. With-profits products provide benefits that are generally either the value of the premiums paid, less charges and fees and with the addition of declared bonuses, or the guaranteed death benefit with the addition of declared bonuses. Smoothing of investment returns is an important feature of with-profits products. It is designed to reduce the impact of fluctuations in investment return from year to year and is accomplished predominantly through the level of final bonuses declared.

The return to Prudential's shareholders in respect of with-profits business Prudential UK writes is an amount equal to up to one-ninth of the value of the bonuses 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.

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(2)

As estimated at March 8, 2011 and included in the consolidated financial statements.

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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 2010, PAC declared a total surplus of £2,367 million (2009: £2,149 million) from PAC's primary with-profits sub-fund, of which £2,131 million (2009: £1,935 million) was added to with-profits policies and £236 million (2009: £214 million) was distributed to shareholders. These amounts included annual bonus rates of 3.0 per cent for the Prudence Bond and 3.0 per cent for personal pensions.

The closed Scottish Amicable Insurance Fund ("SAIF") declared total bonuses in 2010 of £471 million compared to £533 million in 2009. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business. For greater detail on the SAIF fund, see "The SAIF sub-fund and accounts" below.

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

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

The inherited estate, as working capital, enables PAC to support with-profits business by providing the benefits associated with smoothing and guarantees, by providing investment flexibility for the fund's assets, by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus



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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 PAC'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. Prudential UK gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing.

The mis-selling review was completed on June 30, 2002 and the assurance has not applied to new business issued since January 1, 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 July 31, 2009 may only be paid from assets attributable to shareholders. As the pensions mis-selling review was concluded prior to this date, the requirements of the policy statement do not impact the pensions mis-selling provision met from the inherited estate described above.

***The SAIF Sub-fund and Accounts***

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

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

With the exception of certain guaranteed annuity products, referred to below, the majority of SAIF with-profits policies do not guarantee minimum rates of return to policyholders. Should the assets of

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SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency. Due to the quality and diversity of the assets in SAIF and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the Directors believe that the probability of either the PAC's long-term fund or Prudential UK's shareholders' funds having to contribute to SAIF is remote.

***Non-participating Business***

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

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

***Guaranteed Annuities***

PAC used to sell guaranteed annuity products in the United Kingdom and held a technical provision of £24 million as at December 31, 2010, within the main with-profits fund to honor guarantees on these products. PAC's main exposure to guaranteed annuities in the United Kingdom is through SAIF and a provision of £336 million was held in SAIF as at December 31, 2010, to honor 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 an investment-led business whose aim is to generate superior long-term returns for its third party investors and the internal funds of the Prudential Group.

This aim is achieved by creating an environment that is attractive to investment talent. The core focus on investment performance, combined with a well-diversified business mix and established distribution capabilities, has helped M&G achieve strong net sales performance, growth in funds under management and increased profitability.

**Fund management**

In the retail market, M&G's aim is to operate a single fund range and to diversify the distribution base by accessing a wide variety of channels and geographies. In recent years, key themes have included growing the proportion of business sourced from intermediated channels and the increased sales of UK-based funds in European and other international markets.

In the institutional marketplace, M&G's approach centres on leveraging capabilities developed primarily for the Prudential internal funds to create higher margin external business opportunities. This has allowed M&G to offer third-party clients an innovative range of specialist fixed income strategies, including leveraged finance and infrastructure investment.



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**Performance overview**

Delivering fund performance remains critical and is the key determinant of success for an active asset management business. M&G has continued to deliver strong investment performance in 2010 with strong results.

The consistency and excellence of its performance resulted in M&G being awarded the prestigious 2010 Global Group of the Year award at the 15th annual *Investment Week* Fund Manager of the Year Awards. This is the second time in three years that M&G has received this award. Further, M&G's institutional business was also recognized for its investment performance winning the 2010 UK Asset Management Firm of the Year award at *Financial News'* Awards for Excellence in Institutional Asset Management. On the back of this outstanding investment performance M&G delivered net third party fund inflows of £9.1 billion.

Gross fund inflows for the full year rose six per cent to £26.4 billion. This set a new record for the M&G business, surpassing the £24.9 billion achieved in 2009. Maintaining this strong sales performance over 2010, and in some highly volatile markets, demonstrates M&G's strength in depth across all the main asset classes and distribution channels.

2009 was an exceptional year for M&G in terms of net sales. The Retail business experienced unprecedented net purchases of its top-performing bond funds by investors seeking to exploit a near unique opportunity in fixed income markets. On the institutional side, M&G benefited in particular from winning a very substantial single institutional mandate. It was not expected that the business would be able to repeat these levels of net sales in 2010. In the event, the Retail business achieved full year net inflows of £7.4 billion, a decrease of only one per cent compared to the record level of £7.5 billion in 2009. On the institutional side, M&G achieved very healthy net sales of £1.7 billion.

M&G's Retail business in the UK has been number one for gross and net retail sales over nine consecutive quarters based on data to the end of December 2010<sup>(1)</sup>. It was sales of M&G's top-performing fixed income funds that accounted for the lion's share of net inflows in 2009 with 68 per cent of the net retail flows. During 2010, fixed income products continued to sell well, accounting for 43 per cent of flows, but, with market sentiment turning more bullish, investor appetite for our equity and property funds increased. Net inflows into equity funds have increased in share from 26 per cent in 2009 to 48 per cent of total net retail sales in 2010. Over the same period, property funds' share of total net sales trebled to nine per cent.

The improved diversification of sales by asset class was matched by an increased diversification of sales performance by region. In 2009, 19 per cent of net retail flows were from M&G's distribution business outside of the UK, primarily based in Europe. This figure had increased to 39 per cent by the end of 2010.

The retail investment market in Europe is substantially larger than the UK market. In further response to this opportunity, M&G's European Retail business registered its core OEIC fund range for distribution in the Netherlands and Sweden in the fourth quarter of 2010. Registration in both markets has already boosted sales results with M&G being able to leverage off existing client relationships established in other European markets. M&G already has a proven track record of success in distributing into Europe with its registration in France in 2007, for example, having already generated funds under management of £1.3 billion and achieved status as a top ten cross border player in the French market by the end of 2010<sup>(2)</sup>.

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(1) Fundscape Pridham Report

(2) Lipper FMI Saleswatch

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In the institutional market, M&G also attracted healthy net new business on the back of outstanding investment performance with inflows of £1.7 billion. This compares with net inflows of almost £6.0 billion in 2009, although this latter figure was dominated by a single £4 billion fixed income mandate. Like M&G's retail distribution, the institutional business also benefits from an increasingly diverse investor base with distribution activities covering Scandinavia and the Netherlands.

M&G's total funds under management at December 31, 2010 were at a record level of £198.3 billion, up 14 per cent on the 2009 year end. External funds under management at the end of 2010 of £89.3 billion were 27 per cent higher than the start of the year and now represent 45 per cent of M&G's total funds under management.

M&G remains focused on cost control with the cost/income ratio<sup>(1)</sup> at 63 per cent over the full year, an improvement on the 2009 result of 65 per cent. A key aspect to cost management is to create a more flexible operational cost base, where appropriate, to enable the business to react to significant changes in its business profile. During 2010, M&G outsourced fund accounting, taxation and pricing operations for its UK regulated retail funds to an external supplier. The transition of these services has secured for M&G access to a scalable global platform to support both the current and future needs of its funds. Outsourcing this element of its operational platform to a dedicated provider of these services also ensures that M&G can focus on the continued delivery of strong investment performance and winning new business.

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

	<b>At December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>£ billion</b>	
Retail fund management	<b>42</b>	31
Institutional fund management	<b>47</b>	39
Internal fund management	<b>109</b>	104
<b>Total</b>	<b>198</b>	174

**Prudential Capital**

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

The business has consolidated its position in a period of difficult and volatile markets, focusing on liquidity across the Group, management of existing asset portfolio and conservative levels of new investment. Development of new product and infrastructure has continued, helping to maintain the dynamism and flexibility necessary to identify and realize opportunities for profit within acceptable risk parameters. PruCap is committed to continuing to work closely with other business units across the Prudential Group to exploit opportunities and increase value creation for Prudential as a whole. In particular, PruCap offers to the Prudential Group a holistic view on hedging strategy, liquidity and capital management.

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(1) Excluding performance related fees and carried interest on private equity investments.

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**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 appetite framework sets out its appetite for risk exposures as well as its approach to risk management and return optimization. Under this approach, Prudential monitors its risk profile continuously against agreed 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 programs.

***Risk oversight***

**Group risk appetite**

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

- (a) *Earnings volatility*: the objectives of the limits are to ensure that (i) the volatility of its earnings is consistent with its stakeholders' expectations, (ii) the Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks, and (iii) earnings (and cash flows) are managed properly across geographies and are consistent with its funding strategies. The two measures Prudential applies to monitor the volatility of its 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.
- (b) *Capital requirements*: the limits aim to ensure that (a) the Group meets its capital requirements at all times including EU Insurance Groups Directive (IGD) capital requirements, (b) the Group achieves its desired target rating to meet its business objectives, and (c) supervisory intervention is avoided. In addition, Prudential also monitors capital requirements on a local statutory basis.

Prudential's risk appetite framework forms an integral part of its annual business planning cycle. Prudential's Group Risk function monitors the Group's risk profile against the agreed limits. Using submissions from business units, Group Risk calculates the Group's aggregated position (allowing for diversification effects between business units) relative to the limits implied by the risk appetite statements.

Prudential uses a two-tier approach to apply the limits at business unit level. Firstly, Prudential calculates business unit risk limits. These ensure that, provided each business unit keeps within its limits, the Group risk position will remain within the Group limits. Secondly, the impact on the risk position is considered as part of Group Risk's scrutiny of large transactions or departures from plans proposed by individual business units.

In the event that the business unit plans imply risk limits will be exceeded, this will necessitate a dialogue between the executive and the relevant business unit or units. Exceeding Group limits may be avoided if, for example, limits in other business units are not fully utilized, or if the diversification effect at Group level of a particular risk with other business units means the Group limit is not breached.

Market risk is managed such that as conditions evolve the risk profile is maintained within risk appetite. In addition to business unit operational limits on credit risk, Prudential sets counterparty risk limits at Group level. The limits on its total Group-wide exposures to a single counterparty are specified

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within different credit rating "categories". The Group Risk and the Group Credit Risk Committee monitor its actual exposures against these limits on at least a monthly basis, escalating matters to the Group Executive Risk Committee (GERC) as appropriate.

***Risk exposures***

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

<b>Category</b>		<b>Risk type</b>	<b>Definition</b>
1. Financial risks	(a)	Market risk	The risk that arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates.
	(b)	Credit risk	The risk of loss if another party fails to meet its obligations, or fails to do so in a timely fashion.
	(c)	Insurance risk	The inherent uncertainty as to the occurrence, amount and timing of insurance liabilities. This includes adverse mortality, morbidity and persistency experience.
	(d)	Liquidity risk	The risk that a business, though solvent on a balance sheet basis, either does not have the financial resources to meet its obligations as they fall due or can secure them only at excessive cost.
2. Non-financial risks	(a)	Operational risk	The risk of direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events. This includes legal and regulatory compliance risk.
	(b)	Business environment risk	Exposure to forces in the external environment that could significantly change the fundamentals that drive the business's overall objectives and strategy.
	(c)	Strategic risk	Ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Group's capabilities.

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**Financial Risks**

(a) Market risk

*(i) Equity risk*

In the UK business, most of Prudential's equity exposure is incurred in the with-profits fund, which includes a large inherited estate estimated at £6.8 billion<sup>(1)</sup> as at December 31, 2010 (2009: £6.4 billion), which can absorb market fluctuations and protect the fund's solvency. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy.

(1)

As estimated at March 8, 2011 and included in the consolidated financial statements.

In Asia, a high proportion of Prudential's in-force book is made up of unit-linked products with limited shareholder exposure to equities. Prudential has minimal direct shareholder exposure to Asian equity markets outside its unit-linked holdings.

In the US, where Jackson is a leading provider of variable annuities, there are well-understood risks associated with the guarantees embedded in its products. Jackson provides guaranteed minimum death benefits (GMDB) on all policies in this class, guaranteed minimum withdrawal benefits (GMWB) on 64 per cent of the book, and guaranteed minimum income benefits (GMIB) on only six per cent. To protect the shareholders against the volatility introduced by these embedded options, Jackson uses both a comprehensive hedging program and reinsurance. Due to the inability to economically reinsure or hedge the GMIB, Jackson ceased offering this benefit in 2009.

In its variable annuity sales activities, Jackson focuses on meeting the needs of conservative and risk averse customers who are seeking reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers generally select conservative investment options. Jackson is able to meet the needs of these customers because its unique and market leading operational platform allows it to tailor more than 3,400 product combinations.

It is Jackson's philosophy not to compete on price. Jackson's individual guarantees tend to be more expensive than the market average because Jackson seeks to sell at a price capable of funding the cost Jackson incurs to hedge or reinsure its risks.

Jackson uses a macro approach to hedging that covers the entire risk in the US business. Within this macro approach Prudential makes use of the natural offsets that exist between the variable annuity guarantees and the fixed index annuity book, and then use a combination of OTC options and futures to hedge the residual risk, allowing for significant market shocks and limiting the amount of capital being put at risk. Internal positions are generally netted before any external hedge positions are considered. The hedging program also covers the fees on variable annuity guarantees.

Jackson hedges the economics of its products rather than the accounting result. This focus means that Jackson sometimes accepts a degree of variability in its accounting results in order to ensure Jackson achieves the appropriate economic result. Accordingly, while its hedges are effective on an economic basis, due to different accounting treatment for the hedges and some of the underlying hedged items on an IFRS basis, the reported income effect is more variable. This resulted in a negative net equity hedge accounting effect of £367 million in the period (net of related DAC amortization) as compared to an equivalent negative effect of £159 million in 2009. During 2010 Prudential reclassified these effects from operating profit based on longer-term investment returns to short-term fluctuations to ensure the Group's operating results better reflect Jackson's continued focus on optimizing economic value.

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*(ii) Interest rate risk*

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

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. 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 cash flows from investments with the annuity payments. 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 exposure to interest rate risk arising from Asia is at modest levels.

*(iii) Foreign exchange risk*

Prudential principally operates in the UK, the US, and in 13 countries 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 its consolidated financial statements when results are expressed in pounds sterling.

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

*(b) Credit risk*

In addition to business unit 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.

Debt portfolio

1. Information regarding the 2010 results

Prudential's debt portfolio on an IFRS basis was £116.4 billion at December 31, 2010. £54.0 billion of these assets backed shareholder business, of which 95 per cent were investment grade, compared to 93 per cent at December 31, 2009. Sovereign debt represented 16 per cent of the debt portfolio backing shareholder business, or £8.8 billion, at December 31, 2010. Exposures to sovereign debt have increased since December 2009 due mainly to an enlarged position in US Treasuries. Seventy three per cent of this was rated AAA and 93 per cent investment grade. Eurozone sovereign exposures backing

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shareholder business were £3.6 billion at December 31, 2010, of which 99 per cent were AAA rated. Of the remaining one per cent, the highest exposure was in respect of Italy (£52 million) and Spain (less than £1 million) whilst there was no sovereign exposure to Greece, Portugal or Ireland. The total banking exposure to Portugal, Ireland, Italy, Greece and Spain (PIIGS) was £363 million at December 31, 2010.

Asia

Asia's debt portfolio totaled £14.1 billion at December 31, 2010. 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 (84 per cent) in investment grade bonds. For Asia, the portfolio has performed very well, and did not experience any default losses in 2010.

UK

The UK's debt portfolio on an IFRS basis was £74.3 billion as at December 31, 2010, including £46.5 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 £6.0 billion in unit-linked funds where the shareholders' risk is limited, with the remaining £21.8 billion backing the shareholders' annuity business and other non-linked business (of which 80 per cent is rated AAA to A, 18 per cent BBB and two per cent non-investment grade).

On a statutory (Pillar 1) basis at December 31, 2010, Prudential held prudent credit reserves within the UK shareholder annuity funds of £1.8 billion to allow for future credit risk. For Prudential Retirement Income Limited (PRIL) this allowance is set at 68 bps decrease in the valuation discount rate at December 31, 2010 (2009: 71 bps). This now represents 43 per cent of the portfolio spread over swaps compared to 41 per cent as at December 31, 2009. No defaults were reported on the debt portfolio held by the UK shareholder backed annuity business in 2010.

During 2010, Prudential continued to materially reduce its holdings in subordinated financial debt backing its annuity business, improving the overall credit quality of its bond portfolios. This has resulted in gross losses of £104 million on shareholder-backed business and £62 million on with-profits fund backed business in the period. On a Pillar I basis these losses have been fully offset by a reduction in long-term default reserves of £98 million shareholder/£39 million with-profits fund that arose as a result of the improvement in the quality of its remaining bond portfolios and a further release of short-term default reserves of £6 million shareholder and £23 million with-profits fund, which were allocated to the assets sold. On an IFRS basis, the gross costs less the reduction in long-term and short-term default reserves resulted in a small overall pre-tax loss to operating profit of £4 million to shareholders and £15 million to the with-profits fund.

US

The most significant area of exposure to credit risk for the shareholders is Jackson in the US. At December 31, 2010 Jackson's fixed income portfolio totaling £26.4 billion comprised £20.2 billion corporate and government debt, £2.8 billion of residential mortgage-backed securities (RMBS), £2.4 billion of commercial mortgage-backed securities (CMBS) and £1 billion of other instruments.

The US corporate and government debt portfolio of £20.2 billion comprised £17.8 billion of corporate debt and £2.4 billion of government debt. Of the £17.8 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 eight per cent of the portfolio. Jackson's largest sector exposures in the investment grade corporate debt portfolio are Utilities and Energy at 16 per cent and 15 per cent respectively. Prudential actively manages the portfolio and will sell exposures as events dictate.

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Within the RMBS portfolio of £2.8 billion, the agency guaranteed portion is 55 per cent. Another 22 per cent of the portfolio is non-agency prime and Alt-A investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. Jackson's exposure to the 2006/2007 vintages totals £424 million of which £413 million is invested in the senior part of the capital structure, thereby significantly reducing the risk of defaults and the magnitude of loss if a shortfall does occur. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS is only £11 million. The total RMBS portfolio has an average fair value price of 88 cents on the dollar.

The CMBS portfolio of £2.4 billion is performing strongly, with 36 per cent of the portfolio rated AAA and one per cent rated below investment grade. The entire portfolio has an average credit enhancement level of 30 per cent. This level provides significant protection, since it means the bond has to incur a 30 per cent loss, net of recoveries, before Prudential is at risk.

In Jackson, total amounts charged to profits relating to debt securities were £213 million (2009: £631 million). This is net of recoveries/reversals recognized in the year of £10 million (2009: £5 million).

In 2010, Jackson's total defaults were £nil (2009: less than £1 million). In addition, as part of its active management of the book, Prudential incurred losses net of recoveries and reversals of £89 million (2009: less than £1 million) on credit related sales of impaired bonds.

IFRS write-downs excluding defaults for the year were £124 million compared to £630 million in 2009. Of this amount £71 million (2009: £509 million) was in respect of RMBS securities.

The impairment process reflects a rigorous review of every bond and security in Jackson's portfolio. Jackson's accounting policy requires it to book full mark-to-market losses on impaired securities through its income statement. However Prudential 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.

Unrealized gains and losses on debt securities in the US

Jackson's net unrealized gains from debt securities has steadily improved from negative £2,897 million at December 31, 2008 to positive £4 million at December 31, 2009 to positive £1,210 million at December 31, 2010. The gross unrealized loss position moved from £966 million at December 31, 2009 to £370 million at December 31, 2010. Gross unrealized losses on securities priced at less than 80 per cent of face value totaled £224 million at December 31, 2010 compared to £594 million at December 31, 2009.

Asset management

The debt portfolio of the Group's asset management operations of £1.6 billion as at December 31, 2010 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.

2. Information regarding the position at March 31, 2011

On May 11, 2011, Prudential published its first quarter 2011 Interim Management Statement with the UK Listing Authority. This statement included details on credit risk at March 31, 2011 as follows:

Prudential's total debt portfolio on an IFRS basis is estimated at £109.9 billion at March 31, 2011 excluding holdings attributable to external unit holders of consolidated unit trusts. Of this total, £72.8 billion is in the UK, including £45.4 billion within the UK with-profits fund. Shareholders have limited risk exposure to the with-profits fund as its solvency is protected by the inherited estate. Outside the with-profits fund there is £5.7 billion in unit-linked funds where the shareholder risk is limited, with the remaining £21.7 billion backing the shareholder annuity business and other non-linked business (of



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which 79 per cent is rated AAA to A, 19 per cent BBB and 2 per cent non-investment grade). No defaults were reported in the first quarter of 2011 for UK shareholder backed business.

Asia's debt portfolio totals £10.1 billion, of which £6.0 billion is invested in unit-linked and with-profits funds with minimal shareholder risk and £4.1 billion held by shareholder backed non-linked business. No defaults were reported in the first quarter of 2011.

The most significant area of exposure to credit risk for the shareholder remains Jackson in the US. Jackson's fixed income portfolio at March 31 is estimated at £25.5 billion. As reported at December 31, 2010 the net unrealized position continues to benefit from the market recovery from the historically wide spreads experienced at the end of 2008. Jackson's net unrealized gains were £1.2 billion at March 31, 2011 (December 31, 2010: £1.2 billion).

Gross unrealized losses on securities priced below 80 per cent of book value were £0.2 billion at March 31, 2011 (December 31, 2010: £0.2 billion).

Jackson did not experience any defaults on its fixed income portfolio during the first quarter of 2011. Write downs of impaired securities in the first quarter of the year were £6 million which primarily related to Residential Mortgage Backed Securities (RMBS). No write downs were reported on corporate bonds. This compares to total write downs of £35 million for the first quarter 2010.

In addition to the impairments on the debt securities portfolio, Jackson incurred impairments of £9 million on its commercial mortgage book in the first quarter to March 31, 2011 (first quarter 2010: £1 million).

Loans

Of the total Group loans of £9.3 billion at December 31, 2010, £7.1 billion are held by shareholder-backed operations comprised of £4.7 billion commercial mortgage loans and £2.4 billion of other loans.

Of the £7.1 billion held by shareholder-backed operations, the Asian insurance operations held £0.5 billion of other loans, the majority of which are commercial loans held by the Malaysian operation that are rated investment grade by two local rating agencies. The US insurance operations held £4.2 billion of loans, comprising £3.6 billion of commercial mortgage loans, all of which are collateralized by properties, and £0.5 billion of policy loans. The US commercial mortgage loan portfolio does not include any single-family residential mortgage loans and therefore is not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The UK insurance operations held £1.0 billion of loans, the majority of which are mortgage loans collateralized by properties.

The balance of the total shareholder loans amounts to £1.4 billion and relates to bridging loan finance managed by Prudential Capital.

(c) Insurance risk

The processes of determining the price of Prudential's products and reporting the results of its long-term business operations require Prudential to make a number of assumptions. In common with other industry players, the profitability of its businesses depends on a mix of factors including mortality and morbidity trends, persistency, investment performance, unit cost of administration and new business acquisition expenses.

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

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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*

The holding company has significant internal sources of liquidity which are sufficient to meet all of its expected requirements for the foreseeable future without having to make use of external funding. In aggregate the Group has £2.1 billion of undrawn committed facilities, expiring between 2011 and 2015. In addition the Group has access to liquidity via the debt capital markets. Recent issues include a £250 million senior three-year Medium Term Note (MTN) in 2010 and the US\$550 million perpetual subordinated tier 1 securities issued in January 2011. Prudential also has in place an unlimited commercial paper program and has maintained a consistent presence as an issuer in this market for the last 10 years. Liquidity uses and sources have been assessed at a business unit level under base case and stressed assumptions. The liquidity resources available and the subsequent Liquidity Coverage Ratio (LCR) have been assessed to be sufficient under both sets of assumptions.

***Non-financial Risk***

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

With regard to operational risk, the Group is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory, including tax, regimes. Prudential also has a significant number of third-party relationships that are important to the distribution and processing of its products, both as market counterparties and as business partners. This results in reliance upon the operational performance of these outsourcing partners.

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

The Group also 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 components such as risk and control assessments, internal incidents and external incidents, is reported by the business operations 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; the informing of overall levels of capital held; and determination of the adequacy of Prudential's corporate insurance program.

With regard to business environment risk, the Group has a wide-ranging program 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. Where appropriate, Prudential provides submissions and technical input to officials and others, either via submissions to formal consultations or through interactions with officials.

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

**Capital management**

**Regulatory capital (IGD)**

Prudential is subject to the capital adequacy requirements of the European Union (EU) Insurance Groups Directive (IGD) as implemented by the Financial Services Authority (FSA) in the UK. The IGD capital adequacy requirements involve aggregating surplus capital held in its 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 remained strong during 2010. Prudential has continued to place emphasis on maintaining its financial strength through optimizing the balance between writing profitable new business, conserving capital and generating cash. Its IGD capital surplus was £4.3 billion at December 31, 2010 (before taking into account the 2010 final dividend), covering its capital requirements 3.0 times. This compares to a capital surplus of £3.4 billion at the end of 2009 (before taking into account the 2009 final dividend).

The movements during 2010 mainly comprised:

Net capital generation mainly through operating earnings (in-force releases less investment in new business) of £1.7 billion;

Release of tax provisions of £0.2 billion;

Foreign exchange movements of positive £0.1 billion;

Offset by:

Final 2009 dividend, net of scrip, of £0.3 billion and interim 2010 dividend, net of scrip, of £0.1 billion;

Inadmissible assets arising on the purchase of UOB's life insurance subsidiary in Singapore of £0.2 billion;

Impact of costs incurred in relation to the terminated AIA acquisition, net of tax, of £0.3 billion; and

External financing costs and other central costs, net of tax, of £0.2 billion.

Prudential continues to have further options available to it to manage available and required capital. These could take the form of increasing available capital (for example, through financial reinsurance) or reducing required capital (for example, through the mix and level of new business) and the use of other risk mitigation measures such as hedging and reinsurance.

In addition to its strong capital position, on a statutory (Pillar 1) basis, the total credit reserve for the UK shareholder annuity funds also protects its capital position in excess of the IGD surplus. This credit reserve as at December 31, 2010 was £1.8 billion. This represented 43 per cent of the portfolio spread over swaps, compared to 41 per cent as at December 31, 2009.

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Stress testing

As at December 31, 2010 stress testing of its IGD capital position to various events had the following results:

An instantaneous 20 per cent fall in equity markets from December 31, 2010 levels would reduce the IGD surplus by £200 million;

A 40 per cent fall in equity markets (comprising an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four week period) would reduce the IGD surplus by £650 million;

A 150 bps reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £500 million;

Credit defaults of ten times the expected level would reduce IGD surplus by £550 million.

Prudential believes that the results of these stress tests, together with the Group's strong underlying earnings capacity, its established hedging programs and its additional areas of financial flexibility, demonstrate that Prudential 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 continue to maintain a strong position. This assessment provides valuable insights into its risk profile.

2. Information regarding the capital position at March 31, 2011

On May 11, 2011, Prudential published its first quarter 2011 Interim Management Statement with the UK Listing Authority. This statement included details in the capital position as at March 31, 2011 as follows:

Prudential's capital position remains strong. Prudential has continued to focus on maintaining the Group's financial strength through optimizing the balance between writing profitable new business, conserving capital and generating cash. Prudential estimates that its Insurance Groups Directive (IGD) capital surplus was £4.2 billion at March 31, 2011 (after taking into account the 2010 final dividend of £0.4 billion), covering its capital requirements 3.0 times. This compares to £4.3 billion at the end of 2010 (before taking into account the 2010 final dividend) and £3.1 billion at the end of the first quarter of 2010 (after taking into account the 2009 final dividend of £0.3 billion).

The movement in the IGD surplus in the first quarter of 2011 results reflects underlying earnings and the proceeds of the £0.3 billion of hybrid debt issued in January 2011 offset by investment in new business, the 2010 final dividend and foreign exchange movements. The proceeds of the hybrid debt raised are intended to finance the repayments of the Euro 500 million Tier 2 subordinated notes in December 2011.

Prudential continues to have a number of options to manage both available and required capital. These could take the form of increasing its 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.

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

An instantaneous 20 per cent fall in equity markets from March 31, 2011 levels would not materially impact the IGD surplus;

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 £300 million;

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A 150bps reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £450 million;

Credit defaults of ten times the expected level would reduce IGD surplus by £550 million.

In addition to Prudential's strong capital position, on a statutory (Pillar 1) basis the total credit reserve for the UK shareholder annuity funds also contributes to protecting its capital position in excess of the IGD surplus. This credit reserve as at March 31, 2011 was £1.8 billion. This represents 46 per cent of the portfolio spread over swaps, compared to 43 per cent at December 31, 2010.

**Solvency II**

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as "Solvency II". The Solvency II Directive, which sets out the new framework, was formally approved by the Economic and Financial Affairs Council in November 2009 and is expected to be implemented from January 1, 2013. The new approach is based on the concept of three pillars minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

Specifically, Pillar 1 covers the quantitative requirements around own funds, valuation rules for assets and liabilities and capital requirements. Pillar 2 provides the qualitative requirements for risk management, governance and controls, including the requirement for insurers to submit an Own Risk and Solvency Assessment (ORSA) which will be used by the regulator as part of the supervisory review process. Pillar 3 deals with the enhanced requirements for supervisory reporting and public disclosure.

A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies. Companies may be allowed to make use of internal economic capital models if approved by the local regulator.

The European Commission is in the process of consulting on the detailed rules that complement the high-level principles in the Directive, referred to as "implementing measures", which are not expected to be finalized before early 2012.

In particular, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) published a number of consultation papers in 2009 and 2010 covering advice to the European Commission on the implementing measures but there remains significant uncertainty regarding the outcome from this process. Prudential is actively participating in shaping the outcome through its involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Forums, together with the Association of British Insurers (ABI) and the Comité Européen des Assurances (CEA). In addition, further guidance and technical standards are currently being developed by the European Insurance and Occupational Pensions Authority (EIOPA). These are expected to be subject to a formal consultation beginning in late 2011, but may not be finalized until late 2012 or, in some cases, potentially after January 1, 2013.

Many of the issues being actively debated have received considerable focus both within the industry and from national bodies. However, the application of Solvency II to international groups is still unclear and there remains a risk of inconsistent application, which may place Prudential at a competitive disadvantage to other European and non-European financial services groups. There is also a risk that the effect of the measures finally adopted could be adverse for the Group, including potentially a significant increase in capital required to support its business.

Having assessed the high-level requirements of Solvency II, an implementation program 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.

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

***Capital allocation***

Prudential's approach to capital allocation takes into account a range of factors, especially risk adjusted returns on capital, the impact of alternative capital measurement bases (accounting, regulatory, economic and ratings agency assessments), tax efficiency, and wider strategic objectives.

Prudential optimizes capital allocation across the Group by using a consistent set of capital performance metrics across all business units to ensure meaningful comparison. Capital utilization, return on capital and new business value creation are measured at a product level. The use of these capital performance metrics is embedded into its decision-making processes for product design and product pricing.

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

***Risk mitigation and hedging***

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

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

**Risk governance**

*Organization*

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" ("LoD"): risk management, risk oversight and independent assurance.

*Risk management (1<sup>st</sup> LoD):* The 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, and with the Group Chief Executive and the chief executives of each business unit.

*Balance Sheet and Capital Management Committee:* Meets monthly to monitor the Group's liquidity and oversee the activities of Prudential Capital.

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*Risk oversight (2<sup>nd</sup> LoD):* Risk exposures are monitored and reviewed by Group-level risk committees chaired by the Group Chief Risk Officer or the Chief Financial Officer:

*Group Executive Risk Committee:* Meets monthly to oversee the Group's risk exposures (market, credit, liquidity, insurance and operational risks) and to monitor capital.

*Group Operational Risk Committee:* Reports to the Group Executive Risk Committee and meets quarterly to oversee the Group's non-financial (operational, business environment and strategic) risk exposures.

*Group Credit Risk Committee:* Reports to the Group Executive Risk Committee and meets monthly to review the Group's investment and counterparty credit risk positions.

*Solvency II Technical Oversight Committee:* Will be created when the Solvency II program is complete, to provide ongoing technical oversight and advice to the executive and the Board in carrying out their duties with regard to the Group's Internal Model.

The committees' oversight is supported by the Group Chief Risk Officer with functional oversight provided by:

*Group Security:* Develop and deliver appropriate security measures to protect the Group's staff, physical assets and intellectual property.

*Group Compliance:* Verify compliance with regulatory standards and inform the Group's management and the Board on key regulatory issues affecting the Group.

*Group Risk:* Establish and embed 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 Group Audit Committee, supported by Group-wide Internal Audit, provides independent assurance and oversight of the effectiveness of the Group's system of internal control and risk management.

### 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, i.e.:

the retention of the risk contributes to value creation.

the Group is able to withstand the impact of an adverse outcome.

the Group has the necessary capabilities, expertise, processes and controls to manage the risk.

The Group has five objectives for risk and capital management:

*Framework:* Design, implement and maintain a capital management and risk oversight framework consistent with the Group's risk appetite and Risk-Adjusted Profitability (RAP) model.





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*Monitoring:* Establish a "no surprises" risk management culture by identifying the risk landscape, assessing and monitoring risk exposures and understanding change drivers.

*Control:* Implement risk mitigation strategies and remedial actions where exposures are deemed inappropriate and manage the response to extreme events.

*Communication:* Communicate the Group risk, capital and profitability position to internal and external stakeholders and rating agencies.

*Culture:* Foster a risk management culture, providing quality assurance and facilitating the sharing of best practice risk measurement and management across the Group and industry.

*Reporting*

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

The Group Audit Committee and Group Risk Committee are provided with regular reports on the activities of Group Risk. These reports include information on the activities of the Group Operational Risk Committee and Group Credit Risk Committee.

Group Head Office oversight functions have clear escalation criteria and processes for the timely reporting of risks and incidents by business units. As appropriate, these risks and incidents are escalated to the various Group-level risk committees and the Board.

Internal business unit routine reporting requirements vary according to the nature of the business. Each business unit is responsible for ensuring that its risk reporting framework meets both the needs of the business unit (for example reporting to the business unit risk and audit committees) and the minimum standards set by the Group (for example, to meet Group-level reporting requirements).

Business units review their risks as part of the annual preparation of their business plans, and review opportunities and risks against business objectives regularly with Group Head Office. Group Risk reviews and reports to Group Head Office on the impact of large transactions or divergences from business plan.

Table of Contents**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 December 31, 2010. In addition, at December 31, 2010 Prudential had £100.4 billion of external mutual 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 A4 to the consolidated financial statements in Item 18.

**At December 31, 2010**

	UK Insurance	US Insurance	Asia Insurance	Total Insurance	Asset Management (£ million)	Other	Total	Less: assets to cover linked liabilities and external unit holders(b)	Group excluding assets to cover linked liabilities and external unit holders
Investment properties	11,212	26	9	11,247			11,247	(987)	10,260
Investments accounted for using the equity method	69		2	71			71		71
Financial investments:									
Loans	2,302	4,201	1,340	7,843	1,418		9,261		9,261
Equity securities	40,519	31,501	14,464	86,484	151		86,635	(48,835)	37,800
Debt securities	74,304	26,366	14,108	114,778	1,574		116,352	(14,954)	101,398
Other investments	3,998	1,199	382	5,579	59	141	5,779	(134)	5,645
Deposits	9,022	212	638	9,872	80		9,952	(750)	9,202
Total financial investments	130,145	63,479	30,932	224,556	3,282	141	227,979	(64,673)	163,306
Total investments	141,426	63,505	30,943	235,874	3,282	141	239,297	(65,660)	173,637
Derivative liabilities	(792)	(799)	(222)	(1,813)	(78)	(146)	(2,037)	85	(1,952)

Total investments	<b>140,634</b>	<b>62,706</b>	<b>30,721</b>	<b>234,061</b>	<b>3,204</b>	<b>(5)</b>	<b>237,260</b>	<b>(65,575)</b>	<b>171,685</b>
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(a) Investments held by asset management operations are further split in note E2 to the consolidated financial statements in Item 18.

(b) Assets to cover external unit holders relate to assets attributable to unit holders of consolidated unit trusts and similar funds for which an equivalent liability is held in the statement of financial position. Prudential's interest in these trusts and similar funds are included in equity securities within the column "Group excluding assets to cover linked liabilities and external unit holders". This differs from the Group accounts where the funds are consolidated in full with the underlying investments held by the funds being shown in the Prudential's statement of financial position.

The disclosure below has been provided on a consistent 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(i), D3(i), D4(i), E2, G1 and G2 to Prudential's consolidated financial statements in Item 18.

Table of Contents**Prudential's Investment 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 December 31,					
	2010		2009		2008	
	Average investment return	Amount (£ million)	Average investment return	Amount (£ million)	Average investment return	Amount (£ million)
<b>Investment properties</b>						
Net investment income	5.6%	564	6.6%	700	5.6%	676
Net realized investment (losses) gains	0%	4	(0.6)%	(63)	(0.4)%	(51)
Net unrealized investment (losses) gains	5.2%	527	(0.7)%	(76)	(28.2)%	(3,372)
Ending assets		10,260		10,021		11,282
<b>Investments accounted for using the equity method</b>						
Net investment income	0%	0	0%	0	0%	0
Net realized investment gains	78.5%	30	0%	0	0%	0
Net unrealized investment gains	0%	0	0%	0	0%	0
Ending assets		71		6		10
<b>Loans</b>						
Net investment income	5.2%	469	4.8%	461	6.0%	549
Net realized investment (losses) gains	(0.3)%	(26)	(1.1)%	(105)	2.3%	210
Net unrealized investment gains	(0.1)%	(10)	0%	0	0%	0
Ending assets		9,261		8,727		10,378

**Equity securities**

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Net investment income	2.6%	948	3.9%	1,373	3.8%	1,731
Net realized investment gains	4.2%	1,500	5.5%	1,905	4.5%	2,014
Net unrealized investment gains (losses)	6.6%	2,368	14.8%	5,165	(39.7)%	(17,897)
Ending assets		37,800		33,837		35,821
<b>Debt securities</b>						
Net investment income	5.1%	4,823	6.9%	5,939	1.3%	1,071
Net realized investment gains (losses)	1.5%	1,422	(0.7)%	(572)	(0.7)%	(573)
Net unrealized investment gains (losses)	2.3%	2,209	3.9%	3,380	(2.9)%	(2,348)
Ending assets		101,398		88,387		84,929
<b>Other investments (including derivative liabilities)</b>						
Net investment income	0.3%	13	1.2%	32	6.2%	155
Net realized investment (losses) gains	(11.0)%	(403)	(20)%	(541)	(69.7)%	(1,745)
Net unrealized investment (losses) gains	8.2%	299	(0.8)%	(23)	(72.1)%	(1,805)
Ending assets, net of derivative liabilities		3,693		3,604		1,809
<b>Deposits</b>						
Net investment income	0.5%	56	0.7%	64	8.4%	534
Net realized investment gains (losses)	0%	0	0%	0	0%	0
Net unrealized investment gains	0%	0	0%	0	0%	0
Ending assets		9,202		11,891		6,391
<b>Total</b>						
Net investment income	4.2%	6,874	5.5%	8,569	3.0%	4,716

Net realized investment gains (losses)	<b>1.5%</b>	<b>2,526</b>	0.4%	624	(0.1)%	(145)
Net unrealized investment gains (losses)	<b>3.3%</b>	<b>5,394</b>	5.4%	8,446	(16.1)%	(25,422)
Ending assets, net of derivative liabilities		<b>171,685</b>		156,473		150,620

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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 81 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 Prudential Asset Management in Asia. The remaining 19 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 analyzes the liabilities and determines asset allocation, benchmarks and permitted deviations from these benchmarks appropriate for its operation. These benchmarks and permitted deviations are agreed with internal fund managers, who are responsible for implementing the specific investment strategy through their local fund management operations.

**Investments Relating to UK Insurance Business**

*Strategy*

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

Consistent with the product nature, in particular regarding guarantees, the with-profits fund's investment strategy emphasizes a well-diversified equity portfolio (containing some international equities), real estate (predominantly in the United Kingdom), UK and international fixed income securities and cash.

For Prudential's UK pension annuities business and other non-participating business the objective is to maximize 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 maximize investment returns subject to following an investment policy consistent with the representations Prudential has made to its unit-linked product policyholders.

Table of Contents**Investments**

The following table summarizes the total investments, net of derivative liabilities, of the UK insurance business at December 31, 2010.

	<b>At December 31, 2010</b>				<b>Less:</b>	<b>Total</b>
	<b>SAIF</b>	<b>PAC</b>	<b>Other</b>	<b>Total</b>	<b>to cover</b>	<b>excluding</b>
				<b>(£ million)</b>	<b>linked</b>	<b>assets to</b>
					<b>liabilities</b>	<b>cover</b>
					<b>and</b>	<b>linked</b>
					<b>external</b>	<b>liabilities</b>
					<b>unit</b>	<b>and</b>
					<b>holders(a)</b>	<b>external</b>
						<b>unit</b>
						<b>holders</b>
Investment properties	673	8,320	2,219	11,212	(987)	10,225
Investment accounted for using the equity method			69	69		69
Financial investments:						
Loans	153	1,117	1,032	2,302		2,302
Equity securities	3,105	23,945	13,469	40,519	(12,726)	27,793
Debt securities	4,704	41,798	27,802	74,304	(6,796)	67,508
Other investments	276	3,419	303	3,998	(75)	3,923
Deposits	793	6,473	1,756	9,022	(499)	8,523
Total financial investments	9,031	76,752	44,362	130,145	(20,096)	110,049
Total investments	9,704	85,072	46,650	141,426	(21,083)	120,343
Derivative liabilities	(38)	(549)	(205)	(792)	85	(707)
Total investment, net of derivative liabilities	9,666	84,523	46,445	140,634	(20,998)	119,636

(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 December 31, 2010. The "Other" column includes investments relating to solvency capital of unit-linked funds and investments relating to non-life long-term business.

	At December 31, 2010					Total
	With- Profits	PRIL	SAIF	Other	Total	%
	(£ million)					
Investment properties	8,239	1,057	673	256	10,225	8.5
Investments accounted for using the equity method				69	69	0.1
Financial investments:						
Loans:						
Mortgage loans	234	37	22	990	1,283	
Policy loans	13		8		21	
Other loans	870	5	123		998	
Total loans and receivables	1,117	42	153	990	2,302	1.9
Equity securities:						
United Kingdom:						
Listed	15,200	2	1,952	86	17,240	
Unlisted	306		48	4	358	
Total United Kingdom	15,506	2	2,000	90	17,598	14.7
International:						
United States	1,879		185		2,064	
Europe (excluding the United Kingdom)	2,829	1	346	1	3,177	
Japan	754		98		852	
Pacific (excluding Japan)	1,686		237	7	1,930	
Other	1,926	7	239		2,172	
Total international	9,074	8	1,105	8	10,195	8.5
Total equity securities	24,580	10	3,105	98	27,793	23.2
Debt securities:						
UK government	3,950	1,759	293	527	6,529	
US government	514		181	1	696	
Other	36,587	17,289	4,230	2,177	60,283	
Total debt securities	41,051	19,048	4,704	2,705	67,508	56.4
Other investments:						
Participation in investment pools	1,935		216		2,151	
Other financial investments	851				851	
Derivative assets	631	220	60	10	921	

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Total other investments	<b>3,417</b>	<b>220</b>	<b>276</b>	<b>10</b>	<b>3,923</b>	<b>3.3</b>
Deposits	<b>6,473</b>	<b>733</b>	<b>793</b>	<b>524</b>	<b>8,523</b>	<b>7.1</b>
Total investments	<b>84,877</b>	<b>21,110</b>	<b>9,704</b>	<b>4,652</b>	<b>120,343</b>	<b>100.6</b>
Derivative liabilities	<b>(515)</b>	<b>(154)</b>	<b>(38)</b>		<b>(707)</b>	<b>(0.6)</b>
Total investment, net of derivative liabilities	<b>84,362</b>	<b>20,956</b>	<b>9,666</b>	<b>4,652</b>	<b>119,636</b>	<b>100.0</b>

Table of Contents*Equity Securities*

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 £27,793 million invested in equities at December 31, 2010. 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.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
United Kingdom	<b>17,598</b>	<b>63.3</b>
United States	<b>2,064</b>	<b>7.4</b>
Europe (excluding United Kingdom)	<b>3,177</b>	<b>11.5</b>
Japan	<b>852</b>	<b>3.1</b>
Pacific (excluding Japan)	<b>1,930</b>	<b>6.9</b>
Other	<b>2,172</b>	<b>7.8</b>
<b>Total</b>	<b>27,793</b>	<b>100.0</b>

The UK equity holdings are well diversified and broadly mirror the FTSE All-Share share index. Prudential held equities in 442 UK companies at December 31, 2010. The ten largest holdings in UK equities at December 31, 2010 amounted to £6,873 million, accounting for 39.0 per cent of the total UK equity holdings of £17,598 million supporting the UK insurance operations. The following table shows the market value of the ten largest holdings in UK equities at December 31, 2010.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
BP	<b>972</b>	<b>5.5</b>
HSBC Holdings	<b>870</b>	<b>4.9</b>
Vodafone Group	<b>874</b>	<b>5.0</b>
GlaxoSmithKline	<b>692</b>	<b>3.9</b>
Royal Dutch Shell	<b>697</b>	<b>4.0</b>
British American Tobacco	<b>637</b>	<b>3.6</b>
Rio Tinto	<b>897</b>	<b>5.1</b>
B G Group	<b>385</b>	<b>2.2</b>
Astrazeneca	<b>393</b>	<b>2.2</b>
BHP Billiton	<b>456</b>	<b>2.6</b>
<b>Total</b>	<b>6,873</b>	<b>39.0</b>

A wide variety of industry sectors are represented in Prudential's equity portfolio. At December 31, 2010, within the £17,598 million in UK equities supporting the UK insurance operations, Prudential had £14,297 million, or 81.2 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 December 31, 2010.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
Oil and Gas Producers	2,779	15.8
Mining	2,469	14.0
Banks	2,469	14.0
Pharmaceuticals and Biotech	1,553	8.8
Tobacco	942	5.4
Mobile Telecommunications	1,147	6.5
Travel & Leisure	881	5.0
Aerospace and defense	656	3.8
Gas, Water & Multi Utilities	692	3.9
Media	710	4.0
<b>Total</b>	<b>14,298</b>	<b>81.2</b>

Debt Securities

At December 31, 2010, 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, 89.3 per cent were issued by corporations and overseas governments other than the US, 9.7 per cent were issued or guaranteed by the UK government and 1.0 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 December 31, 2010, in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
Securities maturing:		
Within one year	1,445	2.1
Over one year and up to five years	7,754	11.5
Over five years and up to ten years	15,324	22.7
Over ten years and up to fifteen years	9,508	14.1
Over fifteen years	33,477	49.6
<b>Total debt securities</b>	<b>67,508</b>	<b>100.0</b>

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The following table shows debt securities by rating:

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
S&P AAA	16,318	24.2
S&P AA+ to AA-	6,229	9.2
S&P A+ to A-	19,673	29.1
S&P BBB+ to BBB-	11,956	17.7
S&P Other	2,976	4.4
	<b>57,152</b>	<b>84.6</b>
Moody's Aaa	682	1.0
Moody's Aa1 to Aa3	307	0.5
Moody's A1 to A3	596	0.9
Moody's Baa1 to Baa3	857	1.3
Moody's Other	220	0.3
	<b>2,662</b>	<b>4.0</b>
Fitch	580	0.9
Other	7,114	10.5
Total debt securities	<b>67,508</b>	<b>100.0</b>

Real Estate

At December 31, 2010, 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 £10,225 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.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
Office buildings	4,121	40.3
Shopping centers/commercial	3,459	33.8
Retail warehouses/industrial	2,043	20.0
Development	402	3.9
Other	200	2.0
Total	<b>10,225</b>	<b>100.0</b>

Approximately 44.8 per cent of the UK held real estate investment is located in London and Southeast England (Buckinghamshire, Berkshire, East and West Sussex, Hampshire, Isle of Wight, Kent, Oxfordshire and Surrey) with 36.4 per cent located throughout the rest of the UK and the remaining 18.7 per cent located overseas.

Table of Contents**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 December 31, 2010.

	<b>At December 31, 2010</b>		
	<b>Variable annuity separate account assets</b>	<b>Fixed annuity, GIC and other business (£ million)</b>	<b>Total</b>
Investment properties		26	26
Financial investments:			
Loans		4,201	4,201
Equity securities	31,203	298	31,501
Debt securities		26,366	26,366
Other investments		1,199	1,199
Deposits		212	212
Total financial investments	31,203	32,276	63,479
Total investments	31,203	32,302	63,505
Derivative liabilities		(799)	(799)
Total investment, net of derivative liabilities	31,203	31,503	62,706

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The following table further analyzes the investments, net of derivative liabilities of the US insurance operations, excluding the separate account investments supporting the variable annuity business, at December 31, 2010.

	<b>December 31, 2010</b>	
	(£ million)	(%)
<b>Non-institutional</b>		
Investment properties	26	0.1
Loans	3,844	12.2
Equity securities	240	0.7
Corporate securities	16,215	51.5
Government securities	2,345	7.4
Residential mortgage-backed securities	2,572	8.2
Commercial mortgage-backed securities	2,071	6.6
Other debt securities	887	2.8
 Total debt securities	 24,090	 76.5
Other investments	1,199	3.8
Deposits	212	0.7
Derivative liabilities	(528)	(1.7)
 Total non-institutional	 28,988	 92.0
<b>Institutional</b>		
Investment properties		
Loans	357	1.1
Equity securities	58	0.2
Corporate securities	1,576	5.0
Government securities	95	0.3
Residential mortgage-backed securities	212	0.7
Commercial mortgage-backed securities	304	1.0
Other debt securities	89	0.3
 Total debt securities	 2,276	 7.3
Other investments		
Deposits		
Derivative liabilities	(271)	(0.9)
 Total institutional	 2,420	 7.7
<b>Total</b>		
Investment properties	26	0.1
Loans	4,201	13.3
Equity securities	298	0.9
Corporate securities	17,791	56.5
Government securities	2,440	7.7
Residential mortgage-backed securities	2,784	8.9
Commercial mortgage-backed securities	2,375	7.6
Other debt securities	976	3.1
 Total debt securities	 26,366	 83.8
Other investments	1,199	3.8
Deposits	212	0.7
Derivative liabilities	(799)	(2.6)

Total	31,503	100.0
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Under IFRS, debt securities are shown at fair value and loans are at amortized cost. Equity securities and investment properties are shown at fair value. The fair value of unlisted securities is estimated by Jackson using independent pricing services or analytically determined values.

Debt Securities*Corporate Securities*

At December 31, 2010, the US insurance operations had £17,791 million of corporate securities representing 56.5 per cent of US insurance operations total investments excluding separate account investments. Of the £17,791 million, £14,747 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 £3,044 million consisted of investments in non-Rule 144A privately placed fixed income securities.

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

The following table shows the credit quality of the portfolio of publicly traded and Rule 144A fixed income securities at December 31, 2010.

	<b>At December 31, 2010</b>	
	<b>Book Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
NAIC Class Designation		
1	5,338	36
2	8,550	58
3	644	5
4	201	1
5	11	
6	3	
Total	14,747	100

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The following table shows the credit quality of the non-Rule 144A private placement portfolio at December 31, 2010.

	<b>At December 31, 2010</b>	
	<b>Book Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
NAIC Class Designation		
1	1,125	37
2	1,772	58
3	114	4
4	18	1
5	13	
6	2	
Total	3,044	100

*Residential Mortgage-Backed Securities*

At December 31, 2010, the US insurance operations had £2,784 million of residential mortgage-backed securities, representing 8.6 per cent of US insurance operations total investments, excluding separate account investments. At December 31, 2010, 66.5 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 December 31, 2010, the US insurance operations had £2,375 million of commercial mortgage-backed securities, representing 7.6 per cent of US insurance operations total investments, excluding separate account investments. 36 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 December 31, 2010, the US insurance operations had £976 million of other debt securities, representing 3.1 per cent of US insurance operations total investments, excluding separate account investments.

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Loans

At December 31, 2010, loans totaled £4,201 million, representing 13.3 per cent of US insurance operations total investments, excluding separate account investments. Of the total, £3,641 million related to commercial mortgage loans, £548 million to policy loans and £12 million to other loans.

*Commercial Mortgage Loans*

At December 31, 2010, commercial mortgage loans represented 11.6 per cent of US insurance operations total investments, excluding separate account investments. This total included 567 first mortgage loans with an average loan balance of approximately £6.6 million, collateralized 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, emphasizing five main institutional property types: multi-family residential, retail, office, industrial and hotel.

As at December 31, 2010, approximately 31 per cent of the portfolio was industrial, 18 per cent multi-family residential, 19 per cent office, 21 per cent retail, 10 per cent hotel and 1.0 per cent other. Approximately 13.8 per cent of the portfolio is collateralized by properties in California, 9.7 per cent by properties in Texas and 8.4 per cent by properties in Illinois. No other state represents more than six per cent.

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

*Policy Loans*

Policy loans represented 1.7 per cent of US insurance operations total investments, excluding separate account investments at December 31, 2010. Policy loans are fully secured by individual life insurance policies or annuity policies and are contractual arrangements made under the policy.

Equity Securities

Equity securities supporting US insurance operations, excluding separate account investments, totaled £298 million at December 31, 2010.

Other

Other financial investments of £1,199 million, representing 3.8 per cent of US insurance operations total investments, excluding separate account investments at December 31, 2009, were made up of £554 million of limited partnership interests and derivative assets of £645 million.

The largest investment in the limited partnerships category is a £68 million interest in the PPM America Private Equity Fund. The remainder of this category consists of diversified investments in 161 other partnerships managed by independent money managers that generally invest in various equity and fixed income loans and securities.

Table of Contents**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 December 31, 2010. In this table, investments are valued in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

<b>At December 31, 2010</b>							
	<b>With- profits business</b>	<b>Unit- linked assets</b>	<b>Other</b>	<b>Total</b>	<b>Less: assets to cover linked liabilities and external unit holders(a)</b>	<b>Total excluding assets to cover linked liabilities and external unit holders</b>	<b>%</b>
	( <b>£ million</b> )						
Investment properties			9	9		9	0.1
Investments accounted for using the equity method			2	2		2	0.0
Financial investments:							
Loans	874		466	1,340		1,340	7.7
Equity securities	4,321	9,637	506	14,464	(4,906)	9,558	55.1
Debt securities	6,759	3,009	4,340	14,108	(8,158)	5,950	34.3
Other investments	192	58	132	382	(59)	323	1.9
Deposits	6	251	381	638	(251)	387	2.2
<b>Total financial investments</b>	<b>12,152</b>	<b>12,955</b>	<b>5,825</b>	<b>30,932</b>	<b>(13,374)</b>	<b>17,558</b>	<b>101.2</b>
<b>Total investments</b>	<b>12,152</b>	<b>12,955</b>	<b>5,836</b>	<b>30,943</b>	<b>(13,374)</b>	<b>17,569</b>	<b>101.3</b>
Derivative liabilities	(121)		(101)	(222)		(222)	(1.3)
<b>Total investment, net of derivative liabilities</b>	<b>12,031</b>	<b>12,955</b>	<b>5,735</b>	<b>30,721</b>	<b>(13,374)</b>	<b>17,347</b>	<b>100.0</b>

(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 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.

Table of Contents**Debt Securities**

The following table shows rating categorization 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 December 31, 2010.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
S&P AAA	1,331	22.4
S&P AA+ to AA-	1,327	22.3
S&P A+ to A-	798	13.4
S&P BBB+ to BBB-	216	3.6
S&P Other	661	11.1
	<b>4,333</b>	<b>72.8</b>
Moody's Aaa	44	0.7
Moody's Aa1 to Aa3	59	1.0
Moody's A1 to A3	86	1.5
Moody's Baa1 to Baa3	47	0.8
Moody's Other	18	0.3
	<b>254</b>	<b>4.3</b>
Fitch	15	0.3
Other	1,348	22.6
<b>Total debt securities</b>	<b>5,950</b>	<b>100.0</b>

**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 December 31, 2010.

	<b>At December 31, 2010</b>	
	<b>Market Value</b>	
	<b>(£ million)</b>	<b>(%)</b>
Hong Kong	4,650	48.6
Singapore	4,330	45.3
Taiwan	282	3.0
Vietnam	27	0.3
Malaysia	200	2.1
Other	69	0.7
<b>Total</b>	<b>9,558</b>	<b>100.0</b>

Description of Property Corporate Property

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As at December 31, 2010, Prudential's UK headquartered businesses occupied approximately 41 properties in the United Kingdom, Europe, India, South Africa and Namibia. These properties are primarily offices with some ancillary storage and warehouse facilities. Prudential's global headquarters are located in London. Of the remainder, the most significant are offices in London and Reading in England, Stirling in Scotland and Mumbai in India. The property in Stirling is held on a freehold basis, and is leased by the business from PAC's long-term fund. The rest of the properties occupied by

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Prudential's UK based businesses, in the UK, India, South Africa and Namibia, are held leasehold. In Europe, seven of the properties are occupied leasehold and the rest (two) are short term serviced offices. The leasehold properties range in size from 500 to 160,000 sq. ft. Overall, the UK, Europe, Mumbai, South Africa and Namibia occupied property portfolio totals approximately 630,000 sq. ft.

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

Prudential also holds approximately 72 other leasehold properties in the United Kingdom, spread geographically throughout the country. There are also three in Dublin, Ireland. This surplus accommodation totals approximately 615,000 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 564,840 sq. ft. Prudential also leases premises in Michigan, Colorado, Tennessee, California, Illinois, New York, New Jersey, Georgia, Florida, Wisconsin, Massachusetts, Connecticut, New Hampshire, Pennsylvania, Virginia, Indiana and North Dakota for certain of its operations. Prudential holds 30 operating leases with respect to office space, throughout the United States. The leasehold properties range in size from 500-180,000 sq. ft. In the United States, Prudential owns and leases a total of approximately 882,584 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) and Korea.

Within these countries, Prudential owns 44 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 All office space totaling 11,883 sq. ft

Thailand: 11 owned assets All land holdings totaling 73,831 sq. ft

Taiwan: 24 owned assets two office locations totaling 9,530 sq. ft, 20 residual land holdings totaling 44,103 sq. ft & two car parking lots.

Prudential has (excluding India), a total of 407 operating leases, (expense and intercompany leases), totaling approximately 4.13 million square feet of property.

In India, Prudential holds a minority stake in a joint venture with ICICI who hold the property interests. The property is occupied by the ICICIPru Life and ICICIPru AMC businesses. The holding comprises approximately 2,450 properties, totaling approximately 3.5 million sq. ft. There is one owned and occupied asset comprising approximately 30,000 sq. ft in Mumbai.

Prudential Corporation Asia's real estate strategy moving forward involves consolidation of its existing property portfolio to 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.

There have been no property transactions subsequent to December 31, 2010 which would have a material impact on the financial position of Prudential.



Prudential believes that its facilities are adequate for its present needs in all material respects. Prudential confirms that Prudential's owner occupied properties and leased properties are individually

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and collectively not crucial and material to its operations, and that Prudential's operating leases have no material commercial value.

As set out above, Prudential owns 19 properties which Prudential also occupies, which are accounted for as owner occupied property. These properties are comprised of 11 in Asia, one in the UK and seven in the US. The total value of Prudential's owner occupied properties at December 31, 2010 was £172 million. This represents less than 0.1 per cent of Prudential total assets.

Prudential also holds interests in properties within its investment portfolios accounted for as investment property. At December 31, 2010 the total value of investment properties was £11,247 million and comprised 586 properties held by the UK, three held by the US and two held by the Asia business. In total they comprised 4.3 per cent of Prudential's total assets. The UK business' holdings account for over 98 per cent by value of the total investment properties.

Prudential is the lessee under 473 operating leases used as office accommodation, comprising 407 leases held by the Asian business, 30 leases held by the US business and 36 leases held by the UK businesses. For the UK based businesses, Prudential holds two short-term serviced offices and a further 75 leases that are not occupied and represent surplus accommodation.

## 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 levels.

An important competitive factor is the ratings Prudential receives in some of its target markets, most notably in the United States, from recognized rating organizations. The intermediaries with whom the Prudential works, including financial advisers, tied agents, brokers,

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wholesalers and financial institutions consider ratings as one factor in determining which provider to purchase financial products from.

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,

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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 liberalized 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 one or two of Prudential's key markets include HSBC Life in Hong Kong, Korea Life, Kyobo Life and Samsung Life in Korea, Thai Life in Thailand, Great Eastern in Singapore and Malaysia, and China Life, China Pacific and Ping An in China.

**United States**

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

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

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

**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, Resolution, Lloyds Banking Group, Aegon, AXA, Just Retirement, Zurich Financial Services, Fidelity, Invesco Perpetual, Jupiter, Threadneedle, Schroders and BlackRock. Prudential 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" and "M&G" brand names and logos. It is also the registered owner of over 1,000 domain names, including "www.prudential.co.uk", "www.prudentialcorporation-asia.com", "www.jackson.com", "www.mandg.co.uk" and "www.pru.co.uk".

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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 that allege misconduct in the sale and administration of insurance products. Jackson generally accrues a liability for legal contingencies with respect to pending litigation once management determines that the contingency is probable and estimable. Accordingly, at April 15, 2011 Jackson had recorded an accrual of \$29 million for class action litigation. 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.

**Prudential Staff Pension Scheme**

In April 2011 the English High Court found in favor of Prudential in a case involving the Prudential Staff Pension Scheme (PSPS). The case related to the defined benefit section of PSPS and was heard at the request of the trustees of the scheme who were seeking to clarify Prudential's obligations relating to discretionary pensions increases. In his judgment the judge decided that Prudential had acted properly in applying its policy on such increases. Pensioners who were party to the case have indicated that they will not seek to appeal this decision through the courts.

**Sources**

Throughout this annual report, Prudential describes the position and ranking of its overall business and individual business units in various industry and geographic markets. The sources for such descriptions come from a variety of conventional sources generally accepted as relevant business indicators by members of the financial services industry. These sources include information available from the Association of British Insurers, Association of Unit Trusts and Investment Funds, Investment Management Association, Nielsen Net Ratings, Moody's, Standard & Poor's, Fitch, UBS, Life Insurance Marketing and Research Association, the Variable Annuity Research Data Service, referred to as Morningstar/VARDS, LIMRA International, Townsend and Schupp, The Advantage Group, the Life Insurance Association of Singapore, the Hong Kong Federation of Insurers, Life Insurance Association of Malaysia, Life Insurance Association of Taiwan and the Taiwanese Securities Investment Trust Consulting Association, US National Underwriter Insurance Data Services and Service Quality Management Group.

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**SUPERVISION AND REGULATION**

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

**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.

The industry regulations are usually widely drawn and will include provisions governing both financial matters and the way business is conducted in general. Examples include the registration of agents, the approval of products, asset allocation, minimum capital and the basis for calculating the company's solvency and reserves and the valuation of policyholder liabilities. Regulatory authorities may also regulate affiliations with other financial institutions, shareholder structures and the injection of capital and payment of dividends. Financial statements and other returns are filed with the regulators. The regulators may also conduct physical inspections of the operations from time to time.

A number of jurisdictions across Asia require insurance companies to participate in policyholder protection schemes (i.e. contribute to a fund to support policyholders in the event of an insurance company failing).

Prudential Corporation Asia's ("PCA") business units will be required to adhere with Prudential's group-wide policy designed to comply with the EU Solvency II requirements but are not each 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.

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

***Hong Kong The Prudential Assurance Company Limited***

Overview

The Hong Kong branch of PAC is authorized to carry on both long-term business and general business in Hong Kong under a composite license.

The Office of the Commissioner of Insurance ("OCI") is the regulatory body set up for the administration of the Insurance Companies Ordinance ("ICO"). The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority ("IA") for administering the ICO. The principal functions of the IA are to ensure that the interests of policyholders or potential policyholders are protected and to promote the general stability of the insurance industry. The IA has the following major duties and powers:

- (i) authorization of insurers to carry on insurance business in Hong Kong;
- (ii) regulation of insurers' conduct primarily through the examination of the annual audited financial statements and business returns submitted by the insurers; and
- (iii) development of legislation and guidelines on insurance supervision.

The branch is also subject to the codes and guidance stipulated by a self-regulatory body the Hong Kong Federation of Insurers ("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



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responsible for administering the registration and approval of insurance intermediaries of insurance agents, their responsible officers and technical representatives; and handling complaints against them and providing enquiry services to and handling complaints from the public relating to insurance agents. Please see "The Code of Conduct for Insurers", "The Insurance Claims Complaints Bureau" and "Regulation of Insurance Intermediaries" in this section.

In addition, the selling of mandatory pension products by agents is regulated by the Mandatory Provident Fund Authority (the "MPFA"). The MPFA is responsible for the licensing of MPF intermediaries and the supervision of the conduct of MPF intermediaries.

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

In 2010, the Hong Kong government conducted a public consultation on a proposal to make the IA an independent governing body that would be better placed to exercise prudential and regulatory supervision over the insurance industry. A bill regarding the detailed proposal may be introduced to the Legislative Council in 2011. The OCI is also exploring with the HKFI the possibility of setting up a policyholder protection fund in the event of an insurer's insolvency. In addition, the government introduced a bill into the legislative Council in 2010 with detailed proposals that would provide statutory backing and appropriate sanctions for customer due diligence and impose record keeping requirements on financial institutions (including insurance companies), to enhance the anti-money laundering regulatory regime in Hong Kong.

Capital requirements

Pursuant to sections 8(3)(a) and 35AA of the ICO, an insurer is required to maintain at all times an excess of assets over liabilities of not less than a required solvency margin. The objective is to provide a reasonable safeguard against the risk that the insurer's assets may be inadequate to meet its liabilities arising from unpredictable events, such as adverse fluctuations in its operating results or the value of its assets and liabilities.

For general business insurers, the ICO stipulates an absolute minimum solvency margin of HK\$10 million, or HK\$20 million in the case of insurers carrying on Statutory Business. Above these minimum levels, solvency margins are calculated on the basis of the greater of an insurer's relevant premium income (defined as the greater of gross premium income after deduction of reinsurance premium payments or 50 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.



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***Taiwan PCA Life Assurance Company Limited***

PCA Life Assurance Company Limited is licensed for conducting life insurance business in Taiwan.

The Financial Supervisory Commission ("FSC") is responsible for regulating the entire financial services industry, including the bank, security 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 examination of financial institutions. In essence, the FEB conducts on-site visit and examination every two years on the insurance company.

In respect of anti-money laundering, the Investigation Bureau under the Ministry of Justice is responsible for supervision of anti-money laundering and counter-terrorism financing efforts.

According to the Taiwan Insurance Act, a company is not permitted to operate both life and non-life insurance at the same time. Since June 2007 a company operating a non-life license is permitted to distribute Accident & Health ("A&H") products.

Taiwanese laws are based on the civil law system and each competent authority is given powers to develop and issue regulation on specific topics or issues. The FSC prescribes many detailed regulations and enforces rules in respect of the insurance industry.

On April 27, 2010, the Legislative Yuan completed the amendment to the Personal Data Protection Law (previously known as the Computer-Processed Personal Data Protection Law), which will significantly change the requirement for collection, processing and use of personal data. The effective date of this revision has yet to be published.

***Korea PCA Life Insurance Company Limited***

Overview

PCA Life Insurance Company Limited is authorized 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. The FSC thus has the statutory authority to draft and amend financial laws and regulations and issue 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. Therefore, detailed rules under the supervisory regulation are prepared by the FSS.

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. The Republic of Korea operates a civil law system, with the FSC prescribing many detailed regulations for insurers. In the past, the FSC has also been very interventionist in setting and enforcing rules on the insurance industry. In recent years the FSC has moved away from its interventionist approach, responding to the evolving and liberalized landscape, the most prominent change has been a deregulation in asset management and product design activities. In deregularization the FSC has in turn set a strong agenda to strengthen supervision. The regulator maintains risk-based supervision focusing on insurers' operations. This risk-based supervision is composed of the Risk-Based Capital ("RBC")

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solvency requirement, the Risk Assessment and Application System ("RAAS") which assesses insurers' various risks and relevant internal controls, and Risk Disclosure.

Recently, both the Insurance Business Act and Insurance Business Supervisory Regulations were amended to protect customers. The amendments were originally proposed in December 2008 and were passed at a plenary session of the National Assembly on June, 29, 2010 and became effective on January 24, 2011. Among the revisions were those relating to:

- (i) Expansion of the scope of concurrent/ ancillary business which can be conducted by insurance companies;
- (ii) New reporting requirements for foreign insurer's Korean offices;
- (iii) Regulations governing asset management by insurance companies;
- (iv) Updated processes for development of insurance products;
- (v) Prohibitions on corporate insurance agents and corporate insurance brokers from engaging in other business; and
- (vi) New additions to the list of acts prohibited when entering into insurance contracts or soliciting consumers.

Capital requirements

Effective from April 1, 2009, Korea adopted risk-based capital requirements to replace solvency margin measurements. From April 1, 2011, it was mandatory for all insurers to comply with these risk-based capital requirements.

The solvency margin requirement under the Korean Insurance Business Act is intended to ensure that insurers maintain a solvency surplus against future liabilities, and the requirement is based on the European Union solvency ratio model. In particular, all insurers, including branches of foreign insurers, must maintain net assets of equal or greater value to an amount calculated on the basis of the liabilities that they insure such that they maintain a solvency margin ratio of at least 100 per cent.

The risk-based capital requirement was introduced pursuant to amendments to the Insurance Business Supervisory Regulation and its relevant enforcement regulations issued pursuant to the Insurance Business Act. Under this requirement, the ratio of an insurer's available capital to required capital is calculated, and the analysis of equity capital used to determine capital adequacy is expanded, to take into account market, credit, operational, insurance and interest rate risks, which is 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 prompt corrective action which ranges from issuing a recommendation to an insurer to increase its capital reserves or restrict its investments in high-risk securities and other assets to issuing an order to an insurer to suspend its business or transfer it to a third party.

***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 Monetary Authority of Singapore ("MAS") is responsible for insurance regulation and supervision of insurance companies. In order to sell insurance in Singapore,



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companies need to be registered with the MAS. The MAS also has responsibility for supervising compliance with anti-money laundering ("AML") provisions, though suspicious transactions must be notified to the Commercial Affairs Department, an enforcement agency of the Singapore Police Force. In 2007, new regulations were introduced to strengthen further the AML requirements. These were further revised in 2009.

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

The MAS is empowered under the Singapore Insurance Act to promulgate regulations for the sector and also issues, *inter alia*, Notices, Circulars and Guidelines. In practice, the MAS and CPF Board have very detailed legislation frameworks to govern insurance companies and the distribution of insurance products in Singapore.

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

The MAS has also issued Notices that cover the market conduct standards for life insurers such as appointing and training representatives, maximum tier structure, loans and advances, disciplinary action, product disclosure, sales process and replacement (switching) of life policies. The MAS issued a set of guidelines in April 2009 entitled "Guidelines on Fair Dealing Board and Senior Management Responsibility for Delivering Fair Dealing Outcomes to Consumers". In addition, the MAS issued and amended certain regulations, notices and guidelines relating to the Singapore Financial Advisers Act ("FAA") in December 2010; this was due to MAS' implementation of the Representative Notification Framework ("RNF"). Under the RNF, financial institutions will have to notify MAS when they intend to appoint a representative to provide financial advisory or capital markets services under the Singapore FAA and the Singapore Securities and Futures Act ("SFA"). Only representatives whose names appear on the Public Register of Representatives will be allowed to conduct the stated regulated activities.

In 2009 and 2010, MAS issued consultation papers on Regulatory Regime for Listed and Unlisted Investment Products. These aim to:

- (i) promote more effective disclosure;
- (ii) strengthen fair dealing in the sale and advisory process;
- (iii) enhance MAS' powers for breaches of the Singapore FAA;
- (iv) enhance safeguards for retail customers for a wider range of investment products including assessing customer's investment knowledge and experience before selling investment products; and
- (v) expand the scope of the examination module to cover certain investment products.

MAS issued their responses to the feedback received as well as the finalized proposals. Proposals which do not require legislative amendments will be implemented first, whilst proposals that require more substantive legislative amendments will be implemented subsequently.

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Capital requirements

A registered insurer is required at all times to maintain a minimum level of paid-up ordinary share capital and to ensure that its financial resources are not less than the greater of:

- (a) the sum of:
  - (i) the aggregate of the total risk requirement of all insurance funds established and maintained by the insurer under the Singapore Insurance Act; and
  - (ii) where the insurer is incorporated in Singapore, the total risk requirement arising from the assets and liabilities of the insurer that do not belong to any insurance fund established and maintained under the Singapore Insurance Act (including assets and liabilities of any of the insurer's branches located outside Singapore); or
- (b) a minimum amount of 5 million Singapore Dollars.

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

***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 addition, the company is a member of the Life Insurance Association of Malaysia and the General Insurance Association of Malaysia.

In Malaysia, Bank Negara Malaysia ("BNM") is the regulatory body responsible for supervising and regulating the conduct of insurance business. All insurance companies must be licensed by the Minister of Finance. Licensed insurers must comply with the provisions of the Insurance Act 1996, the Insurance Regulations 1996, the Companies Act 1965 and guidelines and circulars issued by BNM. The Life Insurance Association of Malaysia and the General Insurance Association of Malaysia are self-regulated bodies. Resolutions and circulars issued by these associations are binding on the member insurance companies.

At the end of 2006, BNM carried out an exercise of realignment of its regulatory and supervisory functions which resulted in the establishment of a Consumer and Market Conduct Department. More emphasis has been placed on fair market conduct by the insurance industry and protection of consumers' interests.

With the objective of promoting greater transparency in the sale of insurance products, BNM has issued guidelines on the minimum disclosure requirements to be observed by insurers and their intermediaries in their interaction with prospective policy owners. The guidelines specify the timing and minimum information that must be disclosed to a prospective policy owner at the pre-contract stage and at the point of entering into a contract to enable them to make informed decisions and during the term of the contract. This information, which should be timely, clear, concise, accurate, relevant, consistent and comparable and with important information highlighted, includes details of types of cover offered, product features, benefits, restrictions, premium payments and exclusions of the policy as well as any significant conditions and obligations which the policy owner must meet. There are additional product specific disclosure requirements to be met. The Board of Directors or a committee of the Board of Directors is expected to ensure that proper systems and processes are in place to implement the guidelines.

In an effort to further reform the regulation of insurers and reflect better the risks being faced by each entity, BNM has implemented an RBC framework for insurers, which took effect on January 1,

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2009. Compliance with the RBC framework is a condition of licence for all insurers, and any failure to comply with the RBC framework could result in the revocation of an insurer's licence. The RBC framework sets out the capital adequacy ratio calculations, capital requirements to mitigate major risks, the valuation bases for assets and liabilities, and supervisory expectations relating to the investment of insurance funds. Additionally in early 2008, BNM released a consultation paper on risk governance framework for insurers. The consultation paper outlines the risk governance function of an insurer, including the roles and responsibilities of the Board of Directors and management in relation to risk governance. The paper further outlines the function of risk management, compliance and internal audit and their respective oversight responsibilities relating to risk management.

In its risk-based approach in regulating and supervising the insurance industry, more specific responsibilities have been placed on the Board of Directors and senior management in managing the risks of the business. BNM continues to assess the performance of an insurer by analyzing its statutory returns and reports submitted and regular communication with the insurer concerned.

With regard to the subject of Treating Customers Fairly ("TCF"), the Life Insurance Association of Malaysia ("LIAM") embarked on an initiative in early 2010 by working closely with the life insurance companies towards developing a best practice framework for TCF. The TCF framework is intended to raise the professionalism and integrity of the life insurance industry. LIAM is currently in the midst of formalizing the minimum standards to be observed by all life insurance companies as well as to provide a mechanism for LIAM to monitor non-compliance with the TCF requirements.

Capital requirements

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

Under the RBC framework guidelines, the Board of Directors and senior management of 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.

***Malaysia (Takaful business) Prudential BSN Takaful Berhad***

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 is also governed by BNM similarly to the insurance companies. In addition, the business is required to be a member of the Malaysian Takaful Association ("MTA"), which is an association for Takaful operators to improve industry self-regulation through uniformity in market practice and to promote a higher level of co-operation among operators. Resolutions and circulars issued by the MTA are binding on the member Takaful companies.

Takaful in Malaysia is considered to be part of mainstream mercantile law, and hence part of civil law, and is therefore subject to the civil court structure of Malaysia. It is not regulated by Sharia law in Sharia courts. However, the operation system of a Takaful operator must conform to the rules and requirements of Sharia as regulated in the Takaful Act 1984, which elevates the BNM's Sharia Advisory Council to the position as the sole authority on Sharia matters. A Takaful operator is required to establish a Sharia advisory body approved by the BNM and BNM's Sharia Advisory Council will give guidance and advice on the operations and business activities. To strengthen further the Sharia and legal

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infrastructure, the Guidelines on the Governance of the Sharia Framework for Islamic Financial Institutions were issued in 2004 to streamline the functions and duties of Sharia Committee of Takaful operators and strengthen their independence. BNM has in line with efforts to enhance the Sharia governance of Islamic financial institutions, issued a new Sharia governance framework in 2010 to provide a more comprehensive guidance on the roles and responsibilities of the Sharia committee and the board management of Islamic financial institutions in ensuring that the operations of the Islamic financial institutions are in compliance with Sharia principles.

To further promote the orderly growth of Takaful business, the Guidelines on Takaful Operational Framework were issued in December 2010, outlining parameters to govern operational processes of Takaful operators, the various rules and requirements for Takaful operators without limiting or specifying particular contracts to apply to the Takaful operations.

Although the Takaful operator is governed by the same regulator (BNM), the industry is regulated slightly differently from insurance companies. The differences relate mainly to matters where the regulators still find the Takaful operators are not yet ready. For example, the risk-based capital framework that has been implemented for insurers has yet to be implemented for Takaful operators given the nature of the business (i.e. Sharia compliant) and the maturity of the industry. However, as reported in the Financial Stability and Payment Systems Report 2009, the conceptual parameters of the capital model and development of the valuation components for family and general Takaful business under the RBC Framework for Takaful operators ("RBCT") has been substantially completed. The RBCT is still being finalized and the timeline might be further extended for the parallel implementation to 2012. Nonetheless, the implementation timeline is still subject to change. In other areas of Takaful regulation, it is quite similar to the insurance industry.

The regulators acknowledge that comprehensive regulatory and supervisory frameworks need to be developed to support the sound expansion of the Takaful industry. The regulators are taking steps to, among other things: (i) review the Takaful Act 1984 and subsidiary legislation to address existing inadequacies of the acts; (ii) progressively increase the statutory minimum paid up capital for Takaful operators; (iii) introduce accounting standards for Takaful businesses and draft model accounts for Takaful operators; and (iv) monitor and refine further code of ethics and standard market practices for Takaful operators.

BNM has announced that it is undertaking a comprehensive review of the Takaful Act 1984. Detailed proposals of the legislative changes are still to be finalized.

***China CITIC-Prudential Life Insurance Company Limited***

Overview

CITIC-Prudential Life Insurance Company Limited (Prudential's joint venture with CITIC) is authorized to conduct life insurance business in China. As at the end of 2010, CITIC-Prudential Life had business in 33 cities across China, including in the key markets of Guangdong, Beijing, Shanghai, Hubei, Shandong, Zhejiang, Jiangsu, Tianjin, Guangxi, Fujian and Hebei.

The body responsible for regulation of the insurance sector is the Chinese Insurance Regulatory Commission ("CIRC") established in 1998. CIRC reports directly to the State Council. The main laws and regulations that govern the CITIC-Prudential joint venture in China are the Insurance Law of the People's Republic of China (enacted in 1995 and amended in 2009) and the Regulation on the Administration of Foreign Funded Insurance Companies (enacted in 2001) and the Regulation on the Administration of Insurance Companies (enacted in 2004 and amended in 2009).

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CIRC is authorized 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. It drafts relevant regulations regarding insurance supervision, examines and approves the establishment of insurance companies and their branches and supervises market conduct. In November 2008, to ensure enforcement of the regulations, CIRC established a special department, namely the Inspection Bureau, to strengthen the function of investigating significant non-compliance issues and the conduct of insurance companies and the handling of complaints. CIRC has local offices in all the provinces and selected direct administrative cities and regions across the country. One of the key responsibilities of the local offices is to set and administer implementation rules and guidelines in the application of the regulations introduced by CIRC. The local offices will also regulate many aspects of the insurance companies' activities within the locations for which they are responsible, including but not limited to business, sales and agent conducts, sales licensing practices, approving new sales offices and assessing minor administrative penalties.

CIRC has focused specific attention on the area of risk prevention. Accordingly, it has identified five lines of 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 effects of the global financial crisis, more importance has been attached to the supervision of internal control systems, corporate governance, and market conduct and information disclosure of insurance companies. Besides introduction of additional regulations and rules, a classified supervision system was developed by the regulator to detect and monitor the operation and financial risks of the industry. Under the system, insurance companies will be classified into four groups based on the risk indicators relating to solvency margins, corporate governance, capital management, financial status and market conduct. Different administrative measures such as risk warning, on-site inspection, restriction of business expansion and investment, may be imposed on different groups.

China promulgated a new Anti-Money Laundering ("AML") Law applicable to all financial institutions in November 2006. The People's Bank of China ("PBOC") was entrusted with the responsibility and authority for regulating all AML activities in China. PBOC introduced several additional AML measures between November 2006 to June 2007 to provide specific rules and guidelines in the application of the AML Law. The areas covered would include customer identification, reporting large volume and other suspicious transactions, record-keeping and reporting of suspicious transactions involving terrorism financing. CIRC issued a regulation in 2010 requiring insurance companies to observe the AML Law and regulations in capital investment, shares transfer 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.



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***Thailand Prudential Life Assurance (Thailand) Public Company Limited***

Overview

Prudential Life Assurance (Thailand) Public Company Limited (PLT) is regulated and supervised by the Office of Insurance Commission ("OIC"). PLT holds a life insurance license and is authorized to offer life and general insurance products. This also includes an authorization granted by the OIC in December 2010 on offering products with an investment linked feature.

The OIC is the independent regulatory organization handling day-to-day insurance business affairs and reporting to the Ministry of Finance.

The life insurance business is governed by the Life Insurance Act 1992 (as amended by the Life Insurance Act (No. 2) 2008). As well as governing the operations of the life business, this Act regulates funds, investments and insurance policies and imposes a variety of statutory requirements. The OIC has the power to manage and supervise insurance companies, protect insured persons and the general public, implement policies with respect to insurance funds, and regulate the professional conduct, qualifications and licensing of insurance brokers, agents and actuaries.

In 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 initiated a 5 year insurance development plan 2010-2014 with the objective of strengthening the Thai insurance system, developing the quality of the system to meet international standards and preparing for free trade in the future.

Capital requirements

Life insurers are required to maintain capital funds at the greater of 2 per cent of their insurance reserve or 50 million Thai Baht. In its Early Intervention Guidelines, the OIC requires insurers to maintain capital funds of more than 150 per cent of the amount required by law. An insurer that fails to maintain capital funds in line with these guidelines and does not take corrective action to address the deficiency will be subject to sanctions in the form of a range of restrictions on its investment and other business activities.

The 2008 amendments to the Life Insurance Act require the implementation of risk-based capital adequacy tests by 2011.

***Philippines Pru Life Insurance Corporation of UK***

Pru Life Insurance Corporation of UK is licensed and regulated by the Insurance Commission ("IC") as a life insurance company also offers 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 IC. The IC is a government agency under the Department of Finance, and is headed by the Insurance Commissioner.

The mandate of the IC is to regulate and supervise the insurance industry in accordance with the provisions of the Insurance Code in order to ensure that adequate insurance protection is available to the public at a fair and reasonable cost and to ensure the financial stability of the insurance industry so that all legitimate claims of the insured public are met promptly and equitably. The objectives of the IC are to promote growth and financial stability of insurance companies, to develop professionalism in the

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insurance services industry, to develop insurance consciousness among the general populace, to establish a sound national insurance market, and to safeguard the rights and interests of the insured.

The IC issues licenses to insurance companies, reinsurance companies, agents, general agents, resident agents, underwriters, brokers, adjusters and actuaries. It also has the authority to suspend or revoke such licenses under certain circumstances and after observance of the required procedure under the IC Rules of Procedure.

The Insurance Code empowers the IC to adjudicate insurance claims and complaints involving any loss, damage or liability where the amount involved does not exceed Php 100,000 for any single claim. Decisions or orders of the IC may be appealed to the Court of Appeals. Moreover, informal and administrative complaints against malpractices by insurance companies or agents may also be filed with the IC. The IC is available to render assistance in settling any controversy between an insurance company and a policyholder relating to insurance.

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 a Risk-Based Capital Framework (RBC).

***India ICICI Prudential Life Insurance Company Limited***

ICICI Prudential Life Insurance Company Limited (Prudential's joint venture with ICICI) is authorized to carry on long-term insurance business in India.

Insurance is subject to federal regulation in India. The primary legislation is the Insurance Act, 1938, and the Insurance Regulatory & Development Authority Act, 1999. The Insurance Regulatory & Development Authority (the "IRDA") is the key regulator for the ICICI Prudential Life Insurance operation.

The IRDA's duties include the issue of certificates of registration to insurance companies, and it has a mandate to protect the interests of the policyholder, to regulate, promote and ensure the orderly growth of the insurance industry. Regulatory direction is currently focusing on corporate governance and disclosures to stakeholders. IRDA's regulations also encourage the sale of insurance to customers in rural parts of India.

A high-level body, the Financial Stability and Development Council was set up in December 2010, to institutionalize and strengthen the mechanisms for maintaining financial stability without prejudice to the autonomy of regulators. Among other things this council deals with issues relating to financial sector development, macro prudential supervision of the economy, including the functioning of large financial conglomerates, and address inter-regulatory coordination issues. It will also focus on financial literacy and financial inclusion.

There has been a significant volume of regulatory developments in India during the period, the most significant of which was on the product regulation of investment linked policies known as Unit-Linked Insurance Policies ("ULIPs"). The IRDA first issued the ULIPs guidelines on August 4, 2010, with further clarification in subsequent months. The objective of these initiatives is to rationalize the product features of such policies through clauses that:

- (i) increase the minimum lock-in period from three years to five years, with the stipulation being applicable to even top-ups;
- (ii) mandate that charges on ULIPs be spread evenly over the lock-in-period;
- (iii) require that ULIPs, other than single premium products, have a minimum premium paying term of five years;

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- (iv) require that individual products have a minimum policy term of five years, although group products continue to be renewable on an annual basis;
- (v) require that products including pension/annuity have a minimum sum assured payable on death;
- (vi) require that ULIP pension/annuity products offer a minimum guaranteed return of 4.5 per cent per annum or as specified by the IRDA from time to time;
- (vii) require that top up premiums must also have insurance cover;
- (viii) require that the facility of partial withdrawal be permissible only after the fifth policy anniversary for individual products;
- (ix) disallow partial withdrawals in case of pension/annuity products and require that the insurer shall convert the accumulated fund value into an annuity at maturity; and
- (x) all ULIPs, other than pension and annuity products provide the prescribed minimum mortality/health cover.

In addition, the IRDA has issued directions in 2010 on agents and corporate agents and is also proposing changes that are designed to improve the clarity of the products prior to sale and the system to prevent mis-selling.

Further, among other things, regulatory initiatives or changes in the period also cover areas of corporate governance, customer grievance, the level of persistency and anti-money laundering.

***Indonesia PT. Prudential Life Assurance***

PT. Prudential Life Assurance is authorized to carry on long-term (for an indefinite period) insurance business in Indonesia.

The insurance industry is regulated by the Insurance Bureau under the Capital Market and Financial Institution Supervisory Board of the Ministry of Finance. Previously, insurance companies in Indonesia were supervised by the Directorate of Insurance under the Directorate General of Financial Institutions of the Ministry of Finance ("MoF"). In December 2005, the Government of Indonesia merged the Capital Market Supervisory Board and Directorate General of Financial Institutions under a single Capital Market and Financial Institution Supervisory Board ("Bapepam LK"). The current role of Bapepam LK is to act as a supervisory board, with responsibility over capital markets, pension funds, insurance and other non-banking financial institutions with the objective to manage risks in the financial sector, as well as to increase consumer protection and market confidence and promote transparency and strong financial business practices and standards.

The MoF 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, Sharia insurance and know your customer ("KYC") Principles. These decrees are usually supplemented by implementing regulations issued by the Bapepam LK. During 2010, the MoF promulgated and issued the following:

- (i) MoF Regulation No. 30/PMK.010/2010 regarding Implementation of Know Your Customers Principles for Non-Bank Financial Institutions;
- (ii) MoF Regulation No. 18/PMK.010/2010 regarding Sharia Insurance and Reinsurance Business;
- (iii) Good Corporate Governance (GCG) Guidelines on Insurance and Reinsurance Company in Indonesia; and
- (iv) MoF Regulation No. 168/PMK.010/2010 regarding Audit Procedures for Insurance Companies.



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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"). The PPATK is an institution whose mission is the preventing and eradication of money laundering in Indonesia. The Money Laundering Criminal Act Law is the governing statute that establishes and empowers the PPATK as the key authority in the anti-money laundering regime in Indonesia. The Government released an updated statute (and relevant regulations) relating to Money Laundering (Law No. 8 year 2010 of Prevention and Eradication of Money Laundering on October 22, 2010).

Prudential's operations in Indonesia are authorized to distribute life insurance products with either conventional or Sharia principles through agency and bancassurance (including direct marketing) channels. While the regulations for life products with conventional principles are fully developed (in accordance with current market conditions), the government has promulgated new regulations in relation to life products with Sharia principles. The Government has also taken steps to re-visit existing statutes and to assess their ongoing relevance following significant developments in the Indonesian insurance industry over the past few years, such as Law No. 2 of 1992 on Insurance Business. In this context the Government has held meetings with various insurance associations over the past year to obtain input from local as well as joint venture insurance companies. The amendment of Law No. 2 of 1992 on Insurance Business is expected to be promulgated in 2011. In this regard the MoF has registered and submitted the amended Bill to the House of Representatives.

***Japan PCA Life Insurance Company Limited ("PCA Life Japan")***

The Financial Services Agency of Japan (the "JFSA") regulates insurance companies and other financial institutions. In particular, the Insurance Business Division of the JFSA specifically undertakes the supervision of insurance companies. The fundamental principles underlying insurance regulation are set out in the Insurance Business Law. PCA Life Japan is licensed by the Prime Minister of Japan (who delegates most of the supervisory functions to the JFSA) as a life insurance company. PCA Life Japan ceased underwriting new policyholder contracts from February 15, 2010.

The JFSA fundamentally revised the Inspection Manual for Insurance Companies in order to recognize the insurance companies' risk in a comprehensive manner. The Manual applies to inspections after April 2011. The main pillar of this revision is the enhancement of inspection criteria regarding reinsurers' financial strength and the integrated risk management schemes. Additionally, the management responsibility is clearly described as the manual sets out guidelines for a company's management, for responsible persons and for specific issues.

The JFSA revised the standard for calculating solvency margin ratio which is one of the key indicators for supervising insurance companies and will adopt this revised standard beginning from the 2012 financial year end. The stricter capital and risk measurement requirements were introduced as a response to the recent financial crisis.

With the launch of the new financial Alternative Dispute Resolution ("ADR") system in April 2010, financial institutions were required to have contracted a JFSA designated ADR institution by October 1, 2010 to handle future disputes. From October 1, 2010, all life insurers were required to enter into contracts with the Life Insurance Association of Japan (LIAJ) that designate the Arbitration Council within the LIAJ as the designated dispute settlement institution.

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***Vietnam Prudential Vietnam Assurance Private Limited***

Prudential Vietnam Assurance Private Limited is licensed and regulated by the Ministry of Finance of Vietnam (the "MOF") as a life insurance company. Currently, the applicable law does not permit an insurance company to operate both life and non-life insurance at the same time, unless a life insurance company conducts personal health and protection care insurance as a supplement to life insurance.

The MOF is responsible for carrying out state administration of insurance business for and on behalf of the Government. The Insurance Division of the MOF specifically undertakes the supervision of insurance companies. The fundamental principles of the operation of insurance companies are set out in the Insurance Business Law.

The first insurance regulation that was implemented in Vietnam was the governmental decree on insurance No. 100/CP which was issued in late 1993. As the Vietnamese insurance market grew, the first law on insurance business, the Insurance Business Law, was passed in 2000 by the National Assembly of Vietnam. In 2001, the Government promulgated further regulations relating to the implementation of the Insurance Business Law.

At the end of 2007, many of the then current insurance regulations were revised and a number of new regulations were introduced, including: minimum legal capital requirements for insurance enterprises, equivalent to VND 600 billion, security deposit requirements equivalent to two per cent of legal capital; and with respect to investment linked products such as universal life and unit-linked products. The MOF has also provided specific regulations on establishing new insurance companies, modification of licenses or opening/closure of insurers' branches/representative offices and agent recruitment and training.

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.

In 2010, ten years after the application of Insurance Business Law, many issues had arisen. To enhance the insurance business environment and to keep pace with international practice, Law on 61/2010/QH ("Law 61") was passed on December 24, 2010 to amend the Insurance Business Law, effective from July 1, 2011. Under the new law, state administration of insurance business will conduct supervision of insurance business taking the necessary measures to ensure that insurers satisfy their financial requirements for fulfilling their obligations to policyholders.

Circular no. 148/2010/TT-BTC was issued on September 24, 2010 to guide the implementation of anti-money laundering controls in the insurance industry monitored by the Anti-Money Laundering Department under the Banking Inspection, State Bank of Vietnam.

The MOF issued Circular 09/2011/TT-BTC dated January 21, 2011 to unify VAT and CIT for insurance business activities. Notably, scopes of services exempted from VAT or entitled to 0% tax rate are narrowed. According to the Circular, life insurance, accidental dismemberment in life insurance package, hospitalization and surgical, agency training and commission for life insurance corporate agents are not subject to VAT.

**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: The People's Republic of China, Dubai (Dubai International Financial Centre), Hong Kong, Republic of India, Japan, Republic of Korea, Malaysia, Republic of Singapore, Taiwan and Socialist Republic of Vietnam. All operations are authorized and licensed by the relevant authorities, or exempted from licensing under the relevant regulations.

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***Hong Kong***

Certain types of products and services offered by Prudential in Hong Kong are regulated under separate statutory regimes by different regulatory bodies, including the Securities and Futures Commission, the Hong Kong Monetary Authority and the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong) (the "MPFSO"), administered by the Mandatory Provident Fund Schemes Authority ("MPFA") for 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, prospectus requirements for securities and products including mutual funds and unit trusts, as well as investment-linked assurance products. The Hong Kong Securities and Futures Commission ("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.

Prudential Asset Management (Hong Kong) Limited ("PAMHK"), incorporated in Hong Kong, is an ultimately wholly owned subsidiary of the Company. PAMHK is licensed with the HKSFC and is authorized to carry out Type 1 (Dealing in Securities), Type 4 (Advising on Securities) and Type 9 (Asset Management) regulated activities in Hong Kong.

PAMHK is registered with the China Securities Regulatory Commission ("CSRC") as a QFII (Qualified Foreign Institutional Investors) license holder. PAMHK holds a certificate of Investment Registration issued by the Korea Financial Supervisory Service and is also registered with the Korea Financial Supervisory Service as an offshore investment advisor for investment advisory business and investment discretionary management business. The funds registered in Hong Kong by PAMHK 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 with the HKSFC, and is authorized to carry out Type 1, Type 4, Type 5 (Advising on Futures Contracts), Type 6 (Advising on Corporate Finance) and Type 9 regulated activities in Hong Kong. It is also registered with the MPFA as a MPF corporate intermediary. BOCIP offers a comprehensive range of investment products, including MPF products, pension funds, retail unit trusts, institutional mandates and other advisory funds. It also offers private investors and institutional clients investment portfolios and charity fund management services. As one of the pioneers in the asset management industry in Hong Kong, BOCIP launched a series of capital guaranteed funds linked to various underlying indices or baskets of stocks with varying currencies and maturities, as well as certain exchange traded funds which are listed in Hong Kong.

BOCI-Prudential Trustee Limited is a joint venture between Prudential Corporation Holdings Limited (36 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 MPFSO and an associated entity to the BOCIP under the SFO.

***Japan***

PCA Asset Management Limited ("PCAAM") is registered with the Kanto Local Finance Bureau which is under the Financial Services Agency ("JFSA") to engage in (a) second financial instruments business, (b) investment management business, (c) investment advisory & agency business and

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(d) ancillary business under the Financial Instruments and Exchange Act ("FIEA") which became effective as of September 30, 2007.

PCAAM is a member of the Investment Trusts Association, Japan and also a member of the Japan Securities Investment Advisers Association. Both associations are self-regulatory bodies under FIEA. PCAAM is required to comply with the policies and regulations issued by these associations, which are authorized 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, PCAAM focuses on explaining the products and does not aim at the sale of Prudential's funds directly to investors. PCAAM hence does not set up or maintain customer accounts for purposes of investment in Prudential's funds or their settlement, which are to be opened at relevant distributors such as registered financial institutions and type one financial instruments business operators like securities companies. In 2010, PCAAM resolved to start an investment agency business to provide group companies with intermediary services to conduct investment advisory or discretionary agreement with a domestic asset management company for further business opportunity.

***Korea***

Prudential conducts fund business in Korea through an indirect, wholly-owned subsidiary, PCA Asset Management Co. Ltd. The bodies responsible for the regulation of asset management companies, investment advisers and discretionary management companies are the Financial Services Commission ("FSC") and its executive arm, the Financial Supervisory Service ("FSS").

Traditionally, the FSC in Korea operates in a prescriptive way, with a significant amount of detailed regulation that asset management companies must comply with. In recent years, the style of regulation of the indirect investment industry has been changing in line with the trend towards liberalization of financial services. In particular, the regulator is focusing on deregulation in asset management and product design activities and shifting towards a principles-based regulatory regime.

***Taiwan***

The body responsible for regulation of the Securities Investment Trust Enterprises ("SITE"), Securities Investment Consulting Enterprises ("SICE") and discretionary investment business is the Securities and Futures Bureau ("SFB") under the Financial Supervisory Commission ("FSC"). The SFB is responsible for promulgating laws, regulations and policies in relation to these business areas.

PCA Securities Investment Trust Co., Ltd is registered as a SITE with the FSC. It is compulsory that all SITEs are members of the Securities Investment Trust and Consulting Association ("SITCA"), which is a self-regulatory organization ("SRO"). SITE and SICE may not commence business without being admitted as members of the Association. 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 authorized 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.

In 2010, the FSC issued a Circular which, among with other things, allows funds to invest in more types of financial instruments, including domestic managed futures funds, short type ETF, commodity ETF and warrants, and requests formalization of stress testing process for money market funds.

In addition the FSC Circular announced the decrease of investment concentration (from 90% to 70%) in individual offshore funds by Taiwan investors.



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Further, in 2010, the FSC announced the amendments to the "Regulation Governing Offshore Funds" and "Regulations Governing the Public Offering of Securities Investment Trust Funds by Securities Investment Trust Enterprises" as follows:

- a. Both of the regulations prohibit offshore fund institutes, master agents, and SITEs from providing incentives (including but not limited to trailer fee, front-end load sharing, offsite staff training, etc.) beyond those agreed in the distribution agreement;
- b. Fund distributors (including SITEs, banks, securities firm, insurance companies) shall disclose to their customers the fee, reward, incentive, and any other benefits received from offshore fund institutes, master agents, or SITEs. The method of disclosure is to be proposed by SITCA (the business associate) and implemented within 6 months after the issuance of this amendment (by March 3, 2011).

***China***

CITIC-Prudential Fund Management Company Limited, a joint venture between Prudential and CITIC Group (China International Trust and Investment Corporation), is regulated by the China Securities Regulatory Commission ("CSRC"). The CSRC supervises the establishment of fund management companies ("FMCs") and the launch of securities investment funds.

The legislative framework of China's fund industry comprises the China Securities Investment Funds Law (the "Fund Law") and a set of ancillary regulations (the "Fund Regulations"). While the Fund Law and Fund Regulations spell out the rules and requirements which must be adhered to by all FMCs, the supervisory approach of CSRC, to a certain extent, is also principle 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 of product approval, which enables the fund management companies to launch more fund products.

The National People's Congress ("NPC"), China's top legislator, has begun the process of revising the Fund Law. The key proposed changes include registration of hedge funds, individual ownership of fund management companies, lifting of personal trading, and lifting of investment restrictions.

***India***

ICICI Prudential Asset Management Company Limited ("the AMC"), a joint venture between Prudential and ICICI Bank Ltd., is approved by the Securities and Exchange Board of India ("SEBI") under SEBI (Mutual Funds) Regulations, 1996 to act as Investment Manager of ICICI Prudential Mutual Fund (the "Fund"). The Fund was set up as a Trust sponsored by Prudential (through its wholly owned subsidiary Prudential Corporation Holdings Ltd) and ICICI Bank Ltd. ICICI Prudential Trust Limited (the "Trust Company"), a company incorporated under the Companies Act 1956, is the Trustee to the Fund.

Mutual funds in India are regulated by the guidelines and statutes promulgated under the SEBI (Mutual Funds) Regulations, 1996, the Indian Trusts Act, 1882, relevant provisions of the Companies Act 1956 and other applicable laws. Any change of control of the AMC by virtue of 10 per cent or more of voting rights in the AMC or the right to appoint a majority of directors entitled to exercise control of the AMC will require the prior approval of the SEBI and the grant of an option to unit holders to exit the Schemes at the prevailing net asset value without any exit load.

As specified by the Indian Trusts Act 1882 and reiterated by the SEBI regulations, all mutual funds are required to be in the form of trusts. The trustee functions are carried out by separately established trust companies or boards of trustees. In all cases, the trust deed must be approved by the SEBI. The

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AMC has obtained registration from the SEBI to act as a Portfolio Manager under SEBI (Portfolio Managers) Regulations 1993.

SEBI, via its letter dated May 31, 2005, also conveyed that it had no objection to the AMC undertaking Advisory Services to Offshore Funds. The AMC has commenced the provision of Advisory Services.

The AMC also received a mandate from the Central Board of Trustees, Employees Provident Fund Organization to act as a Portfolio Manager for the Funds of Employees Provident Fund, Staff Provident Fund and Pension and Gratuity Fund.

In 2010, AMFI via its circulars (a) advised asset management companies to ensure that KYC formalities are carried out for all individual investors, irrespective of amount of investment, with effect from January 1, 2011, (b) recommended the operational guidelines to implement know your customer (KYC) for all individual investors, (c) advised non-acceptance of third party cheques which had to be implemented by AMCs by November 15, 2010 and (d) revised the criteria for reporting of suspicious transactions by mutual funds, with effect from July 1, 2010.

*Singapore*

Prudential Asset Management (Singapore) Limited ("PAMS"), an indirect wholly owned subsidiary of Prudential plc, holds a Capital Markets Services ("CMS") license, to conduct the regulated activities of fund management and dealing in securities, issued by the Monetary Authority of Singapore under the Securities and Futures Act, Chapter 289. PAMS is also an exempt financial adviser under the Financial Advisers Act, Chapter 110. PAMS is included under the Central Provident Fund Investment Scheme ("CPFIS") and may manage unit trusts included under the CPFIS. In addition, PAMS is registered with the US Securities and Exchange Commission, under the Investment Advisers Act of 1940; the Financial Services Commission of South Korea, as a Cross border Investment Advisor under the Capital Market Consolidation Act and the Securities and Exchange Board of India ("SEBI") under the SEBI (Foreign Institutional Investors) Regulations, 1995. PAMS is also registered as a Foreign Institutional Investment with Japan's Financial Supervisory Authority. Further, PAMS is relying on the Class Order Exemption CO 03/1102 from the Australian Securities and Investments Commission for exemption from the need to hold an Australian financial services 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).

In January 2010, MAS issued a consultation paper on the proposed changes to the Regulatory Regime for Listed and Unlisted Investment Products. One of the proposals is the introduction of the Product Highlights Sheet ("PHS") requirement. MAS issued Guidelines on PHS on October 21, 2010.

A PHS will be in a "Question & Answer" format prescribed by the MAS and will describe, among other things, the profile of customers a given product is suitable for, what the product invests in and what the risks are. The PHS must be provided to investors together with the prospectus before the sale of an investment product

Specifically, the PHS Guidelines applies to new offers of unlisted Collective Investment Schemes ("CIS") for which prospectuses are lodged with MAS on or after March 1, 2011. The PHS Guidelines also apply to existing CIS with prospectuses that expire on or after March 1, 2011. For such CIS, the

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PHS should be submitted to MAS when the updated prospectuses are lodged with MAS, regardless of the date of lodgment. New investment-linked life policy sub-funds submitted on or after March 1, 2011 need to comply with the PHS requirements. For existing investment-linked life policy sub-funds, there will be a one-year transition period for compliance with the PHS requirements. Insurers are required to prepare and submit the PHS for their existing investment-linked life policy sub-funds by November 30, 2011, to ensure that all existing investment-linked life policy sub-funds are in compliance by March 1, 2012.

In addition, in April 2010, MAS issued a consultation paper on proposed changes to the regulatory regime for fund management companies (FMCs) and Exempt Financial Intermediaries affecting the categories under which FMCs are licensed.

MAS conducted a consultation on the proposed amendments to the Code on Collective Investment Schemes in May / June 2010, which, among other things, have significant impact on investment guidelines and limits. The revised code was issued on April 8, 2011 and will come into effect on October 1, 2011 for all authorized schemes other than structured product funds. Structured product funds are allowed to comply with the revised code by April 1, 2012 or be grandfathered.

In 2010, MAS conducted a "closed door" consultation on the proposed amendments to the Regulatory Capital Framework for Capital Markets Services Licensees. MAS indicated that an open consultation will follow after the "closed door" consultation. PAMS is currently subject to the Adjusted Net Capital Framework. Under the proposals in the consultation paper, PAMS would be subject to a risk-based capital framework. The proposals include changes to the computation of risk requirements and financial resources.

***Malaysia***

Prudential Fund Management Berhad ("PFMB") was incorporated in November 2000 and is a wholly owned subsidiary of a Malaysian incorporated company, Nova Sepadu Sdn Bhd, which is in turn a subsidiary of Prudential.

Prudential Al Wara' Asset Management Berhad ("WARA") was incorporated in June 2009 and is a wholly owned subsidiary of Prudential Corporation Holdings Limited. WARA is an Islamic Sharia compliant asset management company. Both PFMB and WARA are regulated by the Securities Commission (the "SC"), which is a statutory body formed under the Securities Commission Act 1993 ("SCA") which reports to the Minister of Finance. It has the power to investigate and enforce the areas within its jurisdiction. Among many other things, SC regulates all matters relating to unit trust schemes and supervises licensed persons dealing in assets and fund management activities and products. The Guidelines on Unit Trust Funds issued by the SC set out requirements with which any person intending to establish a unit trust fund in Malaysia and issue, offer or invite any person to subscribe or purchase units of a unit trust fund must comply. Underpinning all its functions is the SC's ultimate responsibility of protecting the investor. Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia.

Effective June 1, 2010, the Securities Commission Malaysia amended the Guidelines on Unit Trust Funds (GUTF) to facilitate a multi-class structure for unit trust funds, giving investors more flexibility as well as helping the growth of cross-border offerings of Malaysian unit trusts. A single unit trust fund is now able to offer multiple classes of units over a single investment pool, with each class of units capable of having different features with respect to the fees and charges imposed and the currency in which the units are denominated.

The amendments are also expected to facilitate the growth of cross-border offerings of Malaysian unit trust funds under the Mutual Recognition Agreements (MRAs) which the SC has signed with the Dubai International Financial Centre and Hong Kong. Investors holding foreign currencies can now invest

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directly into a class of units denominated in that foreign currency as opposed to converting their investment sum into in Malaysian Ringgit.

***Dubai***

Prudential Asset Management Limited ("PAMD") was incorporated in the Dubai International Financial Centre ("DIFC") in September 2006. PAMD is an ultimately wholly-owned subsidiary of Prudential plc.

PAMD is regulated by the Dubai Financial Services Authority ("DFSA"), which is the independent regulator for DIFC. PAMD holds a license for Dealing in Investments as Agent, Managing Assets, Arranging Credit or Deals in Investments, Advising on Financial Products or Credit, Arranging Custody, Operating a Collective Investment Fund, Providing Fund Administration and Operating an Islamic Window and has a Retail Endorsement on its license.

The supervisory approach of DFSA, to a large extent, is risk-based.

Following the end of the consultation period on a number of proposed legislative changes, a new Collective Investment Law has been enacted in 2010 and the DFSA Rulebook has been amended (effective July 11, 2010). The most relevant change is that a foreign fund manager is allowed to manage local funds (with a fund administrator in the DIFC);

***Vietnam***

Prudential Vietnam Fund Management Private Limited Company ("PVN FMC") was established and currently operates under Business Registration Certificate No. 410400113 issued by the Department of Planning and Investment of Ho Chi Minh City on May 24, 2005 and Licence No. 03/UBCK-GPHDQLQ dated May 26, 2005 and Decision No. 459/QD-UBCK dated August 13, 2007 by the State Securities Commission of Vietnam (SSC) for operation in securities investment fund management and securities portfolio management.

Prudential Vietnam Assurance Private Limited is the sole owner of PVN FMC.

PVN FMC is regulated by the State Securities Commission of Vietnam ("SSC"), which is overseen by the Ministry of Finance ("MOF"). Given its mandate which is to establish and develop the securities markets, the SSC supervises the organization, and operation of securities investment funds and fund management companies.

In late 2007, Prudential also opened a separate consumer finance business in Vietnam authorized by the State Bank of Vietnam.

The Ministry of Finance issued Circular 09/2010/TT-BTC on January 15, 2010 on public disclosures by public companies, listed companies, and fund management companies. The implications of this were to expand the scope of reportable events, to include "any thing that may affect the securities" price, rather than specifying only certain events.

**UK Supervision and Regulation**

**The Financial Services and Markets Act 2000**

Prudential's insurance and investment businesses in the United Kingdom are regulated by the Financial Services Authority ("FSA"), the statutory regulator granted powers under the Financial Services and Markets Act ("FSMA 2000"). In addition, those businesses are subject to various United Kingdom laws (for example, the Data Protection Act 1998 in relation to the processing of customer data and various Pension Acts) some of which require the relevant Prudential entity to be licensed or registered.

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**Risk-based regulation**

The FSA employs a risk-based regulatory approach to supervision under the FSMA 2000 pursuant to which each regulated firm's risk is assessed by the FSA using a risk assessment methodology known as ARROW (Advanced, Risk-Responsive Operating Framework). This is a high-level review aimed at assessing the significance of a particular risk posing threats to the FSA's statutory objectives under the FSMA 2000. These objectives relate to maintaining market confidence, the protection and enhancement of the stability of the UK financial system, securing consumer protection and the reduction of financial crime.

The ARROW framework, supported by a "close and continuous" relationship, is the core of the FSA's risk-based approach to regulation. Using this process, the FSA will consider the particular risks a firm might pose to its statutory objectives by assessing the impact and probability of particular risks materializing.

Prudential is regarded by the FSA as a high impact firm in view of the nature and complexity of its business and as such generally receives ARROW assessments at least once in every two year regulatory period. The last ARROW assessment across Prudential (including Prudential UK) was conducted in July 2008, and the final letter setting out the results of the assessment and the accompanying Risk Mitigation Program which sets out the intended outcomes and follow-up work associated with the assessment was received by Prudential in December 2008. An updated version was provided (for both the Prudential Group and UK businesses) in October 2009. The next FSA ARROW visit for Prudential Group is scheduled to take place during 2011.

Between ARROW visits, the FSA meets regularly with members of senior management and persons holding controlled functions to understand developing strategy and challenges and key issues arising and in particular any significant risks identified and how Prudential is mitigating these. This "close and continuous" supervision is supported by focused (relating to a firm or group) and themed (relating to the industry or market as a whole) visits where appropriate. In advance of discussions, the FSA request relevant mandatory management information at prescribed intervals, which helps to frame the agenda for these meetings.

**Overview of FSMA 2000 regulatory regime**

*Single regulator*

The FSA is currently the single regulator for all authorized persons with respect to regulated activities in the financial services sector. In this regard, the FSA is authorized to make rules and issue guidance in relation to a wide sphere of activity encompassing the governance of a firm, the way it conducts its business and the prudential supervision of firms.

*New regulatory regime*

On May 25, 2010 it was announced that the UK government would be introducing legislation to give the Bank of England control of macro-prudential regulation and oversight of micro-prudential regulation. Following an HM Treasury consultation paper published on July 26, 2010, further detail on the proposals was set out in a second consultation paper published on February 17, 2011. The proposals envisage the FSA ceasing to exist in its current form and the establishment of three new regulators. The Financial Policy Committee (which will sit within the Bank of England) will be given responsibility for macro-prudential regulation and micro-prudential regulation will be overseen by the Prudential Regulation Authority (which will be a subsidiary of the Bank of England). The Financial Conduct Authority will also be established, separate from the Bank of England, and will have responsibility for conduct of business regulation in relation all authorized firms, the prudential regulation of firms not

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regulated by the Prudential Regulation Authority and it will also inherit the majority of the FSA's market regulatory functions.

The FSA is currently preparing for transition to the new regulatory regime and has begun to introduce a shadow internal structure. The intention is for the new regulatory structure to be in place by the end of 2012.

***Permission to carry on "Regulated Activities"***

Under the FSMA 2000, no person may carry on or purport to carry on a regulated activity by way of business in the United Kingdom unless he is an authorized person or is an exempt person. A firm which is authorized by the FSA to carry on regulated activities becomes an authorized person for the purposes of the FSMA 2000. "Regulated activities" are currently prescribed in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended) and include insurance and investment business, as well as certain other activities such as establishing, operating and winding up stakeholder or personal pension schemes, the mediation of general insurance and certain mortgage mediation and lending activities. When authorizing a firm, the FSA will limit the permissions it grants to the regulated activities in which the firm is intending to engage.

***Authorization procedure***

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

Once authorized, and in addition to continuing to meet the threshold conditions for authorization, firms are obliged to comply with the FSA's "Principles for Businesses", which are high level principles for conducting financial services business in the United Kingdom.

Moreover, the FSMA 2000 obliges firms to secure the FSA's prior approval of the appointment of individuals performing certain important functions within a firm or on its behalf with respect to the carrying on of regulated activities (approved persons).

***Principles for Businesses***

An authorized firm will be subject to a range of ongoing regulatory requirements from the FSA, including compliance with general principles as well as more specific conduct of business rules and financial resources requirements. A key feature of the FSA regime is the existence of 11 "Principles for Businesses", by which all firms are expected to abide. These cover key areas such as the firm's relationship with the FSA and the need to act with integrity as well as to treat customers fairly.

In the wake of the recent financial crisis, the FSA has announced, and has followed, a new strategy of "intensive supervision" and a move to what it has described as "outcomes-focused regulation". This has been coupled with a publicly announced strategy of "credible deterrence", involving an increased focus on its enforcement activities.

**Application of FSMA 2000 regulatory regime to Prudential**

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

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**Regulation applicable to the Prudential's insurance and investment businesses**

*Supervision of management and change of control of authorized firms*

The FSA closely supervises the management of authorized firms through the "approved persons" regime, under which any appointment of persons who hold a "controlled function" including functions that enable the exercise of significant influence over an authorized firm must be pre-approved by the FSA.

The FSA also regulates the acquisition and increase of control over UK authorized firms. Under the FSMA 2000, any person proposing to acquire control of or increase control over an authorized firm must first obtain the consent of the FSA. The assessment process and assessment criteria for this process are set out in the FSMA 2000. In considering whether to grant or withhold its approval to the acquisition of control, the FSA must consider, among other things, the suitability of the person seeking consent and seek to ensure the sound and prudent management of the UK authorized firm.

"Control" for these purposes includes a holding of 10 per cent or more in the share capital or voting power of an authorized firm or its parent undertaking or a holding of shares or voting power of an authorized firm or its parent undertaking as a result of which a person is able to exercise significant influence over the management of the authorized firm. When determining a person's level of control, that person's holding of shares or entitlement to exercise voting power will be aggregated with the holdings or entitlements of any person with whom he is "acting in concert". A person will be treated as increasing his control over an authorized firm, and therefore requiring further approval from the FSA, if the level of his shareholding or entitlement to voting power in the authorized firm or, as the case may be, its parent undertaking, increases by any threshold step. The threshold steps occur on the acquisition of 10 per cent, 20 per cent, 30 per cent and 50 per cent of the shares or voting power in an authorized firm or its parent undertaking.

The Acquisitions Directive was introduced across the EU on March 21, 2009, establishing EU-wide procedural and evaluation criteria for the prudential assessment of acquisitions and increases of holdings in the financial sector. The Financial Services and Markets Act 2000 (Controllers) Regulations 2009 gave effect to the Acquisitions Directive in the UK by making various changes to the FSMA 2000.

*Intervention and enforcement*

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

The FSA's enforcement powers, which may be exercised against both authorized firms and approved persons, include public censure, imposition of unlimited fines and, in serious cases, the variation or revocation of permission to carry on regulated activities or of an approved person's approved status. In addition, the FSA may vary or revoke an authorized firm's permission if it is desirable to protect the interests of consumers or potential consumers, or if the firm has not engaged in regulated activity for 12 months, or if it is failing (or is likely to fail) to meet the threshold conditions for authorization. The FSA has further powers to obtain injunctions against authorized persons and to impose or seek restitution orders where persons have suffered loss. Once the FSA has made a decision to take enforcement action against an authorized or approved person (other than in the case of an application to the court for an injunction or restitution order), the person affected may refer the matter to the Financial Services and Markets Tribunal. Breaches of certain FSA rules by an authorized firm may also give a private person who suffers loss as a result of the breach a right of action against the authorized firm for damages.

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In addition to its ability to apply civil sanctions for market abuse, the FSA has the power to prosecute criminal offences arising under the FSMA 2000, insider dealing under Part V of the Criminal Justice Act 1993 and breaches of money laundering regulations. The FSA has indicated that it is prepared to prosecute more cases in the criminal courts where appropriate.

The FSA, although not a creditor, may seek administration orders under the Insolvency Act 1986 (as amended), present a petition for the winding-up of an authorized firm or have standing to be heard in the voluntary winding-up of an authorized firm. It should be noted that insurers carrying on long-term insurance business cannot voluntarily be wound up without the consent of the FSA.

***FSA Conduct of Business Rules***

The FSA's Conduct of Business Rules apply to every authorized firm carrying on regulated activities and regulate the day-to-day conduct of business standards to be observed by authorized persons in carrying on regulated activities. The Conduct of Business Rules incorporate the requirements of the Markets in Financial Investments Directive ("MiFID") which relate to investment business, and now place greater reliance on principles and higher-level rules.

The scope and range of obligations imposed on an authorized firm under the Conduct of Business Rules varies according to the scope of its business and the range of its clients. Generally speaking, however, the obligations imposed on an authorized firm by the Conduct of Business Rules will include the need to categorize its clients according to their level of sophistication, provide them with information about the firm, meet certain standards of product disclosure, ensure that promotional material which it produces is clear, fair and not misleading, assess suitability when advising on certain products, manage conflicts of interest, report appropriately to its clients and provide certain protections in relation to client assets.

***Treating Customers Fairly***

The FSA's Treating Customers Fairly initiative ("TCF") is an important example of its principles-based approach to regulation. This initiative is based upon Principle 6 of the FSA's Principles for Businesses (that a firm must pay due regard to the interests of its customers and treat them fairly).

Although the FSA has, with the exception of rules relating to with-profits policyholders, refrained from making detailed rules on how to comply with TCF, it has published a number of case studies providing an indication of its expectations of authorized firms in the areas of product development, complaints handling, financial promotions and systems and controls. TCF assessments of firms are incorporated into the ARROW assessment process.

***Prudential supervision***

As set out above, in order to maintain authorized status under the FSMA 2000, a firm must continue to satisfy the threshold conditions, which, among other things, require the firm to have adequate resources for the carrying on of its business. The FSA has published detailed rules relating to the maintenance of minimum levels of regulatory capital for all authorized firms including insurance and investment businesses in the Prudential Standards section of its Handbook. The capital adequacy requirements set out in the Handbook which include the type of capital held must be satisfied at all times by authorized firms.

The FSA's regulatory capital rules for insurers and investment firms are primarily contained in the FSA's General Prudential Sourcebook ("GENPRU"), Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") and Prudential Sourcebook for Insurers ("INSPRU"). Although it has been the intention in recent years of the FSA to move towards a unified prudential regime for FSA authorized firms, the FSA has been obliged to revise this approach and its rules to accommodate



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developments at an international level, including EU legislation relating to the regulatory capital requirements for investment firms and financial groups.

*The Financial Ombudsman Service*

Authorized firms must have appropriate complaints handling procedures and the principles of complaints handling are defined in the FSA Handbook. However, once these procedures have been exhausted, qualifying complainants may turn to the Financial Ombudsman Service which is intended to provide speedy, informal and cost-effective dispute resolution of complaints made against authorized firms by individuals and small-business customers. The Ombudsman is empowered to order firms to pay fair compensation for loss and damage and may order a firm to take such steps as the Ombudsman determines to be just and appropriate in order to remedy a complaint. The Financial Ombudsman Service is funded by levies and case fees payable by businesses covered by the Ombudsman.

*The Financial Services Compensation Scheme ("FSCS")*

The FSCS is intended to compensate individuals and small businesses for claims against an authorized firm where the authorized firm is unable or unlikely to be able to meet those claims (generally, when it is insolvent or has gone out of business). The scheme is divided into five "classes": of deposits, investments, insurance mediation, insurance business (life and general) and home finance, reflecting the different kinds of business undertaken by authorized firms. The scheme is funded by contributions from industry participants referable to the particular class and sub-classes within each class, so as to minimize cross-subsidy between authorized persons whose businesses are not similar.

Defaults by investment advisers have resulted in additional levies on the sub-classes to which Prudential is exposed by virtue of M&G. Furthermore, defaults by a number of deposit-takers in 2007 and 2008 led to large payouts by the FSCS, which have been funded mainly by obtaining loans from the Bank of England which were later refinanced by HM Treasury. The outstanding principal on HM Treasury loan is due to be repaid from 2012. A repayment schedule will be agreed between the FSCS and HM Treasury based on market conditions closer to the time and although repayments may be funded by the "general pool" (which is in part funded by levies on the Insurance class in which Prudential sits) current indications are that recoveries from the various defaulting firms will, in large part, be sufficient to repay the outstanding loan. This reduces the possibility that repayments will be funded by the "general pool".

The FSA had commenced a comprehensive review of the FSCS funding model but, in November 2010, postponed its consultation due to uncertainty attributable to changes to implementation of the new UK regulatory regime described above and EU Directives currently under consultation relevant to the funding of such compensation schemes.

**Regulation of insurance business**

Effecting and carrying out contracts of insurance as principal are regulated activities for the purposes of the FSMA 2000, and the carrying on of such regulated activities is referred to as insurance business. Some of the Company's subsidiaries, including PAC, Prudential Annuities Limited, Prudential Retirement Income Limited, Prudential Pensions Limited and Prudential Holborn Life Limited carry on insurance business in the United Kingdom with the permission of the FSA and are regulated by the FSA under the FSMA 2000.

*Conduct of business requirements for insurance business*

The Conduct of Business rules issued by the FSA apply differing requirements to the sale of general and long-term insurance contracts, as well as applying certain requirements to transactions in other designated investments. Authorized 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

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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 (the "RDR") in 2006 with the specific aim of improving the retail investment market. In June 2009 the FSA published a consultation paper containing proposals for implementing the RDR with proposals seeking to: (i) improve the clarity with which firms describe their services to consumers; (ii) address the potential for adviser remuneration to distort consumer outcomes; and (iii) increase the professional standards of advisers. In relation to the first two elements of the RDR, on March 26, 2010 the FSA published a policy statement presenting final rules. These rules include requiring firms to describe services as either "independent" or "restricted" and updating the FSA's rules on what is expected of a firm that describes its advice as being independent. The FSA is also proceeding with proposals to introduce a system of "Adviser Charging", which will involve all firms that give investment advice to retail clients setting their own charges. Once the rules come into effect, adviser firms will no longer be able to receive commissions set by product providers in return for recommending their products, but will have to operate their own charging tariffs in accordance with the FSA's new rules. In relation to the third element of the RDR (increasing the professional standards of advisers), on January 20, 2011, the FSA published a policy statement detailing new reporting and notification requirements and initial and on-going knowledge and accreditation requirements.

The changes introduced by the RDR will have broad-ranging impact on Prudential, including requiring 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.

With limited exceptions for small businesses, the proposals are expected to take effect at the end of 2012.

***Capital requirements for insurers***

The FSA's rules which govern the prudential regulation of insurers are found in INSPRU, GENPRU and the Interim Prudential Sourcebook for Insurers ("IPRU (INS)"). Overall, the requirements of GENPRU are intended to align the capital adequacy requirements for insurance businesses more closely with those of banking and investment firms and building societies, for example, by addressing tiers of capital, rather than looking at net admissible assets. Solvency II, described further below, is the European Commission's project to reform prudential regulation of European Union insurers. A framework directive for the new regime was approved by the European Parliament on April 22, 2009, the final text was adopted by the European Council on November 10, 2009 and the planned implementation date for the regime was October 31, 2012. Subsequently there have been proposals (as discussed below in relation to the Omnibus II proposal) to delay the implementation date to January 1, 2013.

The FSA's rules require an insurer to prepare and submit to the FSA its own assessment of its capital requirements, known as an individual capital assessment ("ICA"), based on the risks it faces. The FSA will review the ICA in order to form its own view of a firm's capital requirements. If the FSA disagrees with a firm's capital requirement assessment, it will issue individual capital guidance ("ICG") which it can impose as a requirement.

The rules also require that insurance companies maintain assets sufficient to meet the relevant capital requirement at all times in respect of both long-term insurance and general insurance business undertaken by the company. The calculation of such capital requirements would be dependent on the type and amount of insurance business a company writes. The method of calculation of the capital requirement is set out in GENPRU and the level of an insurer's capital resources is also determined in accordance with the rules set out in that Sourcebook. Failure to maintain the required capital resources requirement is one of the grounds on which wide powers of intervention conferred upon the FSA may be exercised.

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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.

Determination of the ECR involves the comparison of two separate measurements of the firm's financial resources requirements, which the FSA refers to as the "twin peaks" approach. The term twin peaks is meant to reflect the fact that capital is determined by reference to the higher of the two bases for calculating liabilities (regulatory or realistic). The regulatory basis reflects strict contractual liabilities whereas the realistic one includes more discretionary but expected benefits, including those required to treat customers fairly.

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

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

In December 2010, the FSA introduced new rules that require banks, building societies, insurers and investment firms to undertake reverse stress testing. Reverse stress testing is intended to be separate but complementary to the existing range of stress tests that firms are required to undertake, and is aimed at further improving the understanding of the risks faced by firms. Firms must identify and assess scenarios most likely to cause their current business models to become unviable, being the point at which the market loses confidence in the firm and noting that this is likely to be before the exhaustion of capital resources. 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. Prudential incorporated reverse stress testing capability into its existing structure of stress tests and risk management tools by the implementation deadline of December 14, 2010.

***Actuarial functions***

The rules in the FSA's Supervision Manual require that every insurance company that carries on long-term business must appoint one or more actuaries to perform the "actuarial function" in respect of all classes of its long-term insurance business and, if it has any with-profits business, the "with-profits actuary function" in respect of all classes of that with-profits business.

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

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The actuary performing the "with-profits actuary function" must advise the firm's management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the with-profits business of the firm in respect of which he has been appointed. He must also, at least once a year report to the firm's governing body on key aspects (including those aspects of the firm's application of its Principles and Practices of Financial Management ("PPFM") on which the advice described has been given) of the discretion exercised in respect of the period covered by his report affecting those classes of with-profits business of the firm.

All firms that carry out with-profits business are required to publish the PPFM that are applied in the management of their with-profits funds.

***Distribution of profits and with-profits business***

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

There has been considerable public debate about the rights and legitimate expectations of with-profits policyholders to assets forming part of an insurance company's surplus, particularly where such assets do not derive from the payment of current policyholders' premiums but are rather "inherited" from previous generations of policyholders or from other entities. In 2008, the Treasury Select Committee of the House of Commons conducted an inquiry into the inherited estate held by life assurance companies, one of the recommendations of which was that the FSA consult on a redesign of the regulatory system for with-profits funds.

The FSA confirmed in July 2009 that proprietary life insurance companies will not be able to meet future compensation and redress payments from their with-profits funds. Following two previous consultations, the FSA confirmed a rule change meaning that liabilities arising from operational failures (including mis-selling) after the rule came into effect from July 31, 2009 should be met by shareholder funds rather than policyholder funds. Under FSA rules prior to July 31, 2009, compensation and redress could be paid from assets attributable to shareholders or from the inherited estate of a firm's with-profits fund (if any).

***Treating Customers Fairly and with-profits business***

One of the areas of focus of the FSA's TCF initiative has been with-profits business. The FSA has issued specific rules on this area in relation to with-profits policyholders, which address, among other things, the costs charged to a with-profits fund by the firm managing the fund; penalties and charges levied on policyholders who surrender their policies early, the need for funds to be managed with the objective of ensuring that maturity payouts fall within a target range set for the fund; and the provision of information to with-profits policyholders or potential policyholders in a format that they can more readily understand through the introduction of "Consumer Friendly Principles and Practices of Financial Management" ("CFPPMs").

On February 24, 2011 the FSA published a Consultation Paper which presented proposals for a range of changes to rules and guidance concerning the operation of with-profits funds. The consultation encompasses a number of areas, principally 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

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with-profits funds to make strategic investments; charges made to with-profits funds; 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 (such as rules in relation to the composition of with-profits committees).

Reporting requirements

The main financial reporting rules for insurers are contained in the Interim Prudential Sourcebook for Insurers. Insurance companies must file a number of items with the FSA, including their audited annual accounts and balance sheets and life insurers annual reports from the actuary performing the actuarial function. Returns enumerating policy sales are submitted by firms, including insurance companies on a quarterly basis. Non-insurance companies must also file quarterly returns which include details of sales, numbers of advisers, tests of capital adequacy, balance sheets and profit and loss accounts.

*Transfer of insurance business*

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

*Winding-up rules*

The general insolvency laws applicable to UK companies are modified in certain respects in relation to insurance companies. Since the introduction of the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 (the "2002 Order"), now amended, insurance companies in the United Kingdom have been subject, with some modifications, to the administration regime contained in Part II of the Insolvency Act 1986.

Additionally, in the United Kingdom, all FSA authorized insurance companies, except for pure reinsurers, are subject to the Insurers (Reorganisation and Winding-up) Regulations 2004 (as amended).

These Regulations provide, among other things, that direct insurance claims will have priority over the claims of other unsecured creditors (with the exception of preferred creditors), including reinsurance creditors, on a winding-up by the court or a creditors' voluntary winding-up of the insurance company. Furthermore, instead of making a winding-up order when an insurance company has been proved unable to pay its debts, a UK court may, under section 377 of the FSMA 2000, reduce the amount of one or more of the insurance company's contracts on terms and subject to conditions (if any) which the court considers fit. Where an insurance company is in financial difficulties but not in liquidation, the FSCS may take measures for securing the transfer of all or part of the business to another insurance company.

Section 376 of the FSMA 2000 provides further insolvency protection to policyholders of insurance companies effecting or carrying out contracts of long-term insurance. Unless the court orders otherwise, a liquidator must carry on the insurer's business so far as it consists of carrying out the insurer's contracts of long-term insurance with a view to it being transferred as a going concern to a person who may lawfully carry out those contracts. In carrying on the business, the liquidator may agree to the variation of any contracts of insurance in existence when the winding-up order is made, but must not effect any new contracts of insurance.

*EU Directives on groups*

Prudential is subject to the capital adequacy requirements of the Insurance Groups Directive ("IGD") as implemented in the FSA rules. The IGD pertains to groups whose activities are primarily concentrated in the insurance sector.

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As lead supervisor of Prudential under the IGD, the FSA supervises 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 requires the calculation of group capital resources on a consolidated basis and requires that such group capital resources are equal to or in excess of Prudential's group capital resources requirement (each as calculated in accordance with INSPRU). As lead supervisor of Prudential under the IGD, the FSA also plays 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 FSA regulations as if the companies were directly subject to FSA regulation.

*New EU solvency framework*

The European Commission is continuing to develop a new prudential framework for insurance companies, "the Solvency II project" that will update the existing life, non-life, re-insurance and insurance group's directives. The main aim of this framework is to ensure the financial stability of the insurance industry and protect policyholders through establishing solvency requirements better matched to the true risks of the business. Solvency II adopts a three-pillar approach to prudential regulation which is similar to the "Basel II" approach which has already been adopted in the banking sector in Europe. The pillars are quantitative requirements (Pillar 1); qualitative requirements (Pillar 2); and supervisory and reporting disclosure (Pillar 3).

Although the Solvency II directive has similarities to the current UK regime set out in GENPRU and INSPRU in terms of its risk-based approach to the calculation of capital resources requirements and use of capital tiering, there are also many differences both in terms of substance and terminology.

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

Solvency II is being developed in accordance with the Lamfalussy four-level process. The "Level 1" directive was formally approved by the European Parliament on April 22, 2009 and the final text was adopted by the European Council on November 10 2009 and sets out a framework which will be supplemented by further and more detailed technical implementing measures at "Level 2". Although the process is expected to change following proposals made in the draft Omnibus II Directive (discussed below), currently, at "Level 3", non-binding standards and guidance will be agreed and, at "Level 4", the European Commission will monitor compliance by Member States and take enforcement action as necessary.

On January 19, 2011 the European Commission published the draft Omnibus II Directive, This draft directive proposes a number of amendments to the existing "Level 1" Solvency II directive including to take account of the Lisbon Treaty and the new EU supervisory architecture which is currently being implemented within the EU. The latter has included the establishment of the European Insurance and Occupational Pensions Authority (EIOPA) as the successor to the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) Omnibus II would define the scope of EIOPA's powers in the context of the Solvency II regime, including its powers to resolve disagreements amongst national

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supervisors and to act as a coordinator in "emergency situations". The proposed amendments also define the areas in which draft technical standards may be developed by EIOPA and then be made binding by the European Commission (which would go beyond the non-binding standards and guidance currently to be agreed at "Level 3") and an expanded role for EIOPA in monitoring compliance by Member States.

The opportunity has also been taken in the draft Omnibus II Directive to develop Solvency II in a number of areas unrelated to EIOPA or the Lisbon Treaty. These include extending the date of Solvency II's implementation to January 1, 2013 and authorizing the European Commission to implement transitional measures in certain areas, (subject to specified maximum periods). The areas in which transitional measures can be adopted include a framework within which third country insurance and reinsurance prudential and supervisory regimes that do not meet the criteria for "equivalence" on the implementation of Solvency II may still be treated as equivalent during a transitional period of up to five years thereafter.

**Regulation of investment business**

Certain of Prudential's subsidiaries are authorized by the FSA to carry on investment business. These entities are subject to regulation and supervision by the FSA and must comply with the FSA Conduct of Business and Prudential Rules made under the FSMA 2000.

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

MiFID, unlike its predecessor legislation, the Investment Services Directive, sets out detailed and specific requirements in relation to organizational and conduct of business matters for investment firms and regulated markets. In particular, MiFID and its implementing measures make specific provision in relation to, among other things, organizational requirements, outsourcing, client categorization, conflicts of interest, best execution, client order handling and suitability and appropriateness, and investment research and financial analysis, pre- and post-trade transparency obligations and transaction reporting and make substantial changes to the responsibility for the supervision of cross-border investment services provided by firms in exercise of their single market passport rights.

On December 8, 2010 the European Commission launched a public consultation on MiFID, which closed on February 2, 2011. The consultation covered a range of issues including: addressing developments in market structures and, in particular, new trading venues, participants and products entering the market since MiFID was introduced; improvements to pre- and post-trade transparency in EU equity markets (including in relation to "dark pools"), and new measures on pre- and post-trade transparency in non-equity markets; improvements to the availability, quality and consolidation of trading data; measures specific to commodity derivative markets; clarifications and extensions to transaction reporting; investor protection; and further changes to the supervision of various activities, particularly in light of the new European supervisory architecture.

The European Commission currently plans to adopt a legislative proposal for amending MiFID on June 1, 2011. The proposals will then pass to the European Parliament and the Council for consideration.

***Capital requirements for investment businesses***

The FSA's capital requirements for investment businesses are also contained in the Prudential Standards section of its Handbook, primarily in GENPRU and BIPRU. These rules implement the requirements of European Union legislation relating to the prudential supervision of investment firms, including the Capital Adequacy Directive (Directive <sup>93/6</sup>/EEC), as re-cast by the Capital Requirements Directive (Directive 2006/49/EC).

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***Liquidity requirements for investment businesses***

In October 2009 the FSA published its final rules on the liquidity requirements expected of BIPRU firms, which are designed to enhance firms' liquidity risk management practices. The qualitative aspects of the new rules, which affect the systems and controls that firms are required to have in place to deal with liquidity risk, came into force on December 1, 2009. The quantitative aspects of the new rules are subject to staggered implementation. The rules require changes to firms' business models and include an updated quantitative regime (in the form of Individual Liquidity Adequacy Standards (ILAS)) coupled with a narrow definition of liquid assets, enhanced systems and control requirements and more frequent reporting requirements.

***Alternative Investment Fund Managers Directive (AIFMD)***

The European Parliament agreed the Alternative Investment Fund Managers Directive, a directive designed to regulate private equity and hedge funds, in November 2010. Implementation of the directive by national regulators is expected to be completed by mid-2013. The European Securities and Markets Authority (ESMA) is due to provide advice to the European Commission on the detailed rules at Level 2 which will implement the Directive. ESMA issued a consultation on possible implementation measures in April 2011 and its formal advice is expected in Summer 2011.

Many of Prudential's early concerns regarding the impact of the directive have been allayed with the agreement of its final text, however the way in which the regime established under the Directive operates in practice will in large part be determined by the Level 2 (legislation) and Level 3 (guidance) measures to be adopted by the European Commission and ESMA before the Directive comes into force. Further clarification is awaited by Prudential, in particular, regarding delegation to non EU regulated entities and the rules relating to the precise identification of an alternative investment fund manager under the Directive.

**US Supervision of M&G Investment Management**

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

**US Supervision and Regulation**

**US regulation**

***Overview***

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

Insurance regulatory authorities in the jurisdictions in which Jackson does business require it to file detailed quarterly and annual financial statements and these authorities have the right to examine its operations and accounts. In addition, Jackson is generally subject to federal and state laws and regulations that affect the conduct of its business. New York and Michigan require their state insurance



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authorities to conduct an examination of an insurer under their jurisdiction at least once every five years. The New York insurance authorities completed a triennial examination of Jackson National Life of New York in 2010 for the examination period of January 1, 2006 through December 31, 2008. Michigan insurance authorities completed an examination of Jackson in 2010 for the period January 1, 2005 through December 31, 2008. There were no material findings in the final examination reports issued 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 December 31, of the immediately preceding year, or the net gain from operations of the insurer, not including realized capital gains, for the prior year. In 2008, 2009 and 2010, Jackson paid shareholder dividends of US\$313.1 million, US\$250.0 million, and US\$275.0 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 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.

***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. Prudential estimated its reserve for future guarantee fund assessments for

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Jackson to be £15.4 million (US\$24.9 million) at December 31, 2009. Prudential estimated its reserve for future guarantee fund assessments for Jackson to be £15.9 million (US\$24.9 million) as December 31, 2010. The Prudential Group believes this reserve to be adequate for all anticipated payments for known insolvencies.

*Asset valuation reserve*

State regulators generally require that insurers establish an asset valuation reserve that consists of two components: a "default component" to provide for future credit-related losses on fixed income investments and an "equity component" to provide for losses on all types of equity investments. The asset valuation reserve establishes statutory reserves for fixed maturity securities, equity securities, mortgage loans, real estate, derivative instruments and other invested assets. The reserve is designed to provide for a normalized 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.

*Interest maintenance reserve*

State regulators generally require that insurers establish an interest maintenance reserve to defer non-credit-related realized capital gains and losses, net of taxes, on fixed income investments (primarily bonds, derivative instruments and mortgage loans) which are amortized 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 realized capital gains and losses on fixed maturity investments and deferred gains or losses resulting from market value adjustments on policies and contracts backed by assets that are valued at book value.

*The National Association of Insurance Commissioners ratios*

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners annually calculates 12 financial ratios to assist state regulators in monitoring the financial condition of insurance companies. A usual range of results for each ratio is used as a benchmark and departure from the usual range on four or more of the ratios can lead to inquiries from individual state insurance departments. In 2009 and 2010, all of Jackson's ratios fell within 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 2010 opinion has been submitted to the Michigan Office of Financial and Insurance Regulation without any qualifications.

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***Jackson's capital and surplus***

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

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

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 December 31, 2010 and expires October 1, 2011, unless extended by the Michigan Insurance Commissioner. The effects of this permitted practice may not be considered by Jackson 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 combination of formula-based and model-based standards. The model-based standard is primarily used to evaluate market risk for variable annuities, while the formula-based standard applies generally to all products and is comprised of factors applied to various asset, premium, and reserve items. 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 capitalized companies for purposes of initiating regulatory action. The National Association of Insurance Commissioners intended the formula as a regulatory tool only and did not intend it as a means to rank insurers generally. The model act imposes broad confidentiality requirements on those engaged in the insurance business (including insurers, agents, brokers and others) and on state insurance departments as to the use and publication of risk-based capital data.

Any state adopting the model act gives the state insurance commissioner explicit regulatory authority to require various actions by, or take various actions against, insurance companies whose adjusted capital does not meet minimum risk-based capital standards. The Michigan 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 December 31, 2010, the Company's total adjusted capital under the National Association of Insurance Commissioners' definition substantially exceeded Michigan minimum capital 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.

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*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, as amended (the "Securities Act"), and the Investment Company Act of 1940, as amended (the "Investment Company Act"). In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product is organized as separate accounts that are unit investment trusts.

Curian Capital, LLC and Jackson Investment Management LLC are registered with the SEC pursuant to the Investment Advisers Act and are also registered or notice filed in all applicable states.

Curian Clearing, LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Curian Clearing, LLC is a member firm of the Financial Industry Regulatory Authority (the "FINRA").

Jackson National Life Distributors LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Jackson National Life Distributors LLC is a member firm of the FINRA.

National Planning Holdings, Inc. ("NPH") owns four retail-broker dealers, being IFC Holdings, Inc. (doing business as INVEST Financial Corporation) ("IFC"), Investment Centers of America, Inc ("ICA"), National Planning Corporation ("NPC") and SII Investments, Inc. ("SII"). These entities are registered as broker-dealers, investment advisers, and insurance agencies (or affiliated with insurance agencies), and are licensed and qualified to transact business pursuant to their respective registration on licensure with the SEC and state securities and insurance authorities, and membership with FINRA and the Municipal Securities Rulemaking Board. NPC, SII, and ICA are also members of the National Futures Association ("NFA"). Membership of the NFA is required for commodities and futures trading.

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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 an adviser or sub-adviser to other US, UK and Asian entities affiliated with Prudential, other institutional clients such as CDOs or similar structured vehicles and private investment funds (in which PPM America affiliates such as Prudential UK entities and Jackson are generally investors), US mutual funds and other foreign-pooled investment vehicles primarily sponsored by affiliated entities, UK based unit trusts or OEICs, a SICAV and similar vehicles sponsored by affiliates, unaffiliated US and foreign institutional accounts, as well as a limited number of trusts of individuals and their family members. Currently, only a limited number of PPM America clients are unaffiliated or have underlying investors who are unaffiliated institutions, trusts or individuals. The US mutual funds for which PPM America serves as sub-adviser are subject to regulation under the Securities Act and the Investment Company Act, and other similar vehicles organized outside of the US may also be subject to regulation under applicable local law.

PPM America and certain of its subsidiaries are subject to various levels of regulation under the federal securities laws that the SEC administers as well as state securities laws. In connection with providing investment advisory services to certain of its clients, PPM America may also be subject to regulation under applicable foreign laws.

To the extent that PPM America or the NPH broker-dealers maintain accounts with assets of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), or the Internal Revenue Code, they may be subject to certain restrictions imposed by ERISA or the Internal Revenue Code. Such restrictions are summarized in "Employee Benefit Plan Compliance" in the Section below. The US Department of Labor (the "Department of Labor") and the US Internal Revenue Service have interpretive and enforcement authority over the applicable provisions of ERISA and the Internal Revenue Code.

*Employee benefit plan compliance*

Jackson issues certain types of general account stable value products, such as GICs and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. Many of these plans are retirement plans that are subject to the fiduciary standards of ERISA and that are tax-qualified under the Internal Revenue Code. As such, Jackson may be subject to certain restrictions imposed by ERISA and taxes imposed by the Internal Revenue Code. These restrictions include:

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

the requirements under ERISA that fiduciaries may not engage in "conflict of interest" transactions, and

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

In general, the Internal Revenue Code imposes taxes on persons involved in certain of the transactions described above.

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

In the instance where an insurer issues a guaranteed benefit policy to a plan, ERISA provides that the insurer need not become a fiduciary with respect to the plan solely as a result of the issuance of the

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policy. Under Section 401 of ERISA, a guaranteed benefit policy means an insurance policy to the extent such policy provides for benefits the amount of which the insurer guarantees.

In 1993, in *John Hancock Mutual Life Insurance Company v. Harris Trust & Savings Bank*, the US Supreme Court held that a portion of the funds held under a certain type of general account annuity contract did not constitute a "guaranteed benefit policy" within the meaning of ERISA, a holding which potentially exposes insurers with similar types of contracts to the application of ERISA's fiduciary and prohibited transaction provisions in connection with the management of assets in their general accounts.

Although no assurances can be given, Jackson believes that none of its contracts 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 Services Oversight 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 promulgated and administered by the US Federal Reserve Board, including, among 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.

Other changes in the Dodd-Frank Act include the creation of a new "Federal Insurance Office" within the Treasury Department that will, among 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 harmonized standard of care for investment advisers and broker-dealers which provide personalized advice about securities to retail customers; and requiring that certain derivatives be traded on registered exchanges and cleared through registered central counterparties.

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 organizations 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 also been formed that is opposed to the so-called optional federal charter. Prudential cannot predict whether any federal charter or any other

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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, fixed-index 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.

**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**

Prudential is an international retail financial services group with significant operations in Asia, the US and the UK. Prudential serves over 25 million customers and has £340 billion of assets under management. Prudential is structured around four main business units: Prudential Corporation Asia, Jackson, Prudential UK and M&G.

Prudential is a leading life insurer in Asia operating in 12 markets. Prudential is in the top three for market share of new business in Hong Kong, India, Indonesia, Malaysia, Singapore, the Philippines and Vietnam. In Asia Prudential provides a comprehensive range of savings, protection and investment products tailored to meet customers' needs in each market. Prudential's Asian asset management business manages investments across a broad range of asset classes for internal, retail and institutional clients. Prudential is one of the region's leaders of Asian sourced assets under management. Prudential is also the largest onshore mutual fund manager in Asia.

Jackson is one of the largest life insurance companies in the US, providing retirement savings and income solutions to more than 2.8 million customers. Jackson is also one of the top three 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 seven 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 £198 billion (at December 31, 2010). M&G has been investing money for individual and institutional clients for 80 years. It is one of Europe's largest active investment managers.

**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 legislation and regulation, as discussed in greater detail below. In addition, changes in interest rates and returns from equity, real estate and other investments as well as volatility in these items may affect Prudential's profitability.



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See Item 3 "Key Information Risk Factors" for more information on risks associated with these and other factors. In addition, changes to the composition of its businesses and the execution of its growth strategy may result in increased variation in profits from year to year.

**General economic and market conditions**

2010 was a good year for the Group in uncertain conditions as global economies emerged from the financial crisis. Prudential believes these results demonstrate that the Group is maximizing the growth opportunities of its high quality franchises in Asia, the United States, and the United Kingdom. Prudential remains disciplined in its approach of optimizing value and is very focused on improving the quality of its earnings.

Particular features for the Prudential's geographic areas of operations are shown below:

***Asia***

The Asian economies continue to lead the world in terms of current and prospective growth and it is clear that Asia's historic reliance on exports is increasingly balanced with rapidly growing domestic consumption. Across the region Prudential is seeing major demographic and socioeconomic changes with the emergence of a sizeable and growing middle class. The Asian Development Bank estimates that there are now over 1.9 billion middle class Asians, a threefold increase since 1990 and this means that, within a generation, hundreds of millions of households in the region have ascended from poverty to living standards and lifestyle aspirations that are consistent with those seen in Western Europe and the US. These are urbanized households that are smaller, that are better educated, that want good quality housing, consumer goods, access to good medical services, transport, holidays, entertainment, education, to provide a quality of life for their children that is better than the one they had and not least to have a long life with a comfortable retirement.

Household savings rates in Asia have historically been multiples of those in the UK and US and in markets where little exists in the way of state backed social security benefits or welfare support, the need to save in case of an unplanned life changing event such as a medical incident involving hospitalization is real and strong. As households have become wealthier the quantum of these emergency funds has increased materially, resulting in significant amounts of undeployed or under-deployed capital waiting to be brought into the formal economy as they migrate to insurance companies' and banks' balance sheets. Life insurance companies are ideally placed to provide some financial protection and security to household balance sheets.

Although there will inevitably be some short-term fluctuations in demand for life insurance and asset management products as other factors come into play, the fundamental social and political drivers for growth in these sectors will continue to support long-term growth.

In 2010, in line with its strategy, Prudential's core investment was in the fast growing and highly profitable markets of South-East Asia and Hong Kong and Singapore. Due to the long-term structural changes taking place in these economies, Prudential continues to believe it offers the most attractive opportunity in the global life insurance market today.

***United States***

The United States is the world's largest retirement savings market. Each year, more of the 78 million baby boomers<sup>(1)</sup> reach retirement age, triggering a shift from savings accumulation to retirement income generation for more than \$10 trillion of accumulated wealth over the next decade<sup>(2)</sup>.

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(1) Source: US Census Bureau

(2) Source: McKinsey

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During 2010, the US financial services industry continued to face many challenges. The recovery witnessed in the first quarter reversed in the second quarter but was more visible again in the third and fourth quarters. At half year, the S&P 500 index was down 7.6 per cent, 10-year Treasury rates had dropped below three per cent, swap rates had declined to near historic lows, AA corporate spreads had increased slightly and volatility had risen to levels more consistent with the first half of 2009. By year-end, the S&P 500 index was up 12.8 per cent for the year. 10-year Treasury rates, continued to decline through the third quarter before increasing in the fourth quarter, finished the year at 3.3 per cent, down from 3.9 per cent at the end of 2009. Swap rates also declined through the third quarter before rebounding slightly in the fourth quarter, although they still were near historic lows at year-end. Corporate AA spreads and volatility both declined through the second half of the year to fall below year-end 2009 levels.

Prudential believes these unstable market conditions continue to provide a competitive advantage to companies with strong financial strength ratings and a relatively consistent product set. Companies that were hardest hit by the market disruption over the last few years are in general still struggling to regain market share as customers and distributors continue to seek product providers that offer consistency, stability and financial strength. Jackson continues to benefit significantly from this flight to quality as its financial strength ratings from the four primary rating agencies have remained unchanged for more than eight years. Through its financial stability and innovative products that provide clear value to the consumer, Jackson has enhanced its reputation as a high-quality and reliable business partner, with sales increasing as more advisers have recognized the benefits of working with Jackson.

Jackson's strategy continues to focus on balancing volume and capital consumption for both variable and fixed annuities. Jackson continued to sell no institutional products during 2010, as available capital was directed to support higher-margin variable annuity sales.

Jackson was predominantly a spread-based business until recently, with the majority of its assets invested in fixed income securities. Recently its fee-based business has become more prominent and now represents a significant part of Jackson's business mix.

In general, Jackson's results are heavily affected by fluctuations in economic and market conditions, especially interest rates, credit conditions and equity markets. The profitability of Jackson's spread-based business depends in large part on its ability to manage interest rate spreads, as well as the credit and other risks inherent in its investment portfolio. Jackson designs its US products and manages the investments supporting this business to reduce interest rate sensitivity. This has the effect of moderating the impact on Prudential's results of changes in prevailing interest rates.

Changes in interest rates either upward or downward, including changes in the difference between the levels of prevailing short-term and long-term rates, can expose Jackson to the risk of not earning anticipated spreads between the rate earned on investments and the rate credited on its policies. For example, if interest rates go up and/or competitors offer higher crediting rates, withdrawals on annuity contracts may increase as policyholders seek higher investment returns elsewhere. In response, Jackson could (i) raise its crediting rates to stem withdrawals, decreasing its spread; (ii) sell assets which may have depressed values in a high interest rate environment, creating realized investment losses; or (iii) pay out existing cash which would otherwise have earned interest at the higher interest rates. Moreover, to the extent that Jackson holds illiquid private placements and commercial mortgages, there is a risk that it will incur losses if it needs to sell those assets.

Conversely, if interest rates decrease, withdrawals from annuity contracts may decrease relative to original expectations, creating more cash than expected to be invested at lower rates. Jackson may have the ability to lower the rates it credits to policyholders as a result, but may be forced to maintain crediting rates for competitive reasons or because there are minimum interest rate guarantees in certain contracts. In either case, the spread earned by Jackson would be lowered.

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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 utilize 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 utilization 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 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 UK has a mature life and pensions market which is characterized by an ageing population in particular, through two waves of baby-boomers born after World War II and in the 1960s with wealth distribution significantly skewed and very much concentrated in the 45-74 age group. In this context, the retirement and near-retirement segments are highly attractive.

UK consumers are insufficiently prepared as they will have to face increasingly long periods of retirement. This will result in longer working lives and a more flexible approach towards retirement. It will also mean that the baby-boomers will need to target their wealth on the provision of dependable retirement income. Prudential UK's expertise in areas such as longevity risk management and multi-asset investment, together with its financial strength and strong brand, mean that the business is strongly positioned in the retirement planning space with a particular focus on with-profits and annuities.

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, the shareholders' profits under IFRS are significantly influenced by the contribution from the growing shareholder backed annuity business. The key factors affecting the profitability of this business are described in note D2 to the consolidated financial statements in Item 18.

**Government policy and legislation**

Changes in government policy or legislation applying to companies in the financial services and insurance industries in any of the jurisdictions in which Prudential operates, particularly in 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.

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**Regulation**

In recent years, the insurance sectors in the markets in which Prudential operates have seen considerable regulatory change. Failure to comply with local regulation may result in sanctions, which could take the form of a financial penalty.

In the United States, Jackson has been the subject of class action litigation which is discussed in more detail in Item 4 "Information on the Company Business of Prudential Legal Proceedings". Whilst the outcome of such matters cannot be predicted with certainty, Prudential believes that the ultimate outcome of such litigation and regulatory issues will not have a material adverse effect on Prudential's financial condition, results of operations, or cash flows. Changes in pension, financial services and tax regulation could have an impact on Prudential's results.

**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.

**IFRS Critical Accounting Policies**

Prudential's discussion and analysis of its financial condition and results of operations are based upon Prudential's audited consolidated financial statements, prepared in accordance with International Financial Reporting Standards 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 IFRS have not been endorsed by the EU. As at December 31, 2010, there were no unendorsed standards effective for the three years ended December 31, 2010 affecting the consolidated financial information of Prudential, and there were no differences between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the three years ended December 31, 2010 is prepared in accordance with IFRS as issued by the IASB. It is Prudential's policy to adopt mandatory requirements of new or altered EU-adopted IFRS standards where required, with earlier adoption applied where permitted and appropriate in the circumstances.

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

Critical accounting policies are defined as those that are reflective of significant judgments 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 Prudential's results insofar as they relate to Prudential's shareholder-financed business. In particular, this applies for Jackson, which is the largest shareholder-backed business in Prudential. The policies are not critical in

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respect of Prudential'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.

Additional explanation is provided below and in cross-referenced notes within the consolidated financial statements in Item 18, as to why the distinction between with-profits business and shareholder-backed business is relevant.

The items discussed below and in cross-referenced notes within the consolidated financial statements in Item 18 explain the effect of changes in estimates and the effect of reasonably likely changes in the key assumptions underlying these estimates as of the latest statement of financial position date so as to provide analysis that recognizes the different accounting effects on profit and loss or equity. In order to provide relevant analysis that is appropriate to the circumstances applicable to Prudential's businesses, the explanations refer to types of business, fund structure, the relationship between asset and policyholder liability measurement, and the differences in the method of accounting permitted under IFRS 4 for accounting for insurance contract assets, policyholder liabilities and unallocated surplus of Prudential's with-profits funds.

**Investments**

*Determining the fair value of financial investments when the markets are not active*

Prudential 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 judgment.

If the market for a financial investment of Prudential is not active, the fair value is determined by using valuation techniques. Prudential 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).

As at December 31, 2010, £4,573 million (2009: £5,557 million) of the financial investments (net of derivative liabilities) valued at fair value were classified as level 3. Of these, £866 million (2009: £1,684 million) are held to back shareholder non-linked business, and so changes to these valuations will

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directly impact shareholders' equity. Further details of the classification of financial instruments are given in note G1 to the consolidated financial statements in Item 18.

**Determining impairments relating to financial assets**

*Available-for-sale securities*

**1. Information regarding the 2010 and 2009 results**

Financial investments carried on an available-for-sale basis are represented by Jackson's debt securities portfolio. The consideration of evidence of impairment requires management's judgment. In making this determination the factors considered include, for example:

Whether the decline of the financial investment's fair value is substantial.

A substantial decline in fair value might be indicative of a credit loss event that would lead to a measurable decrease in the estimated future cash flows.

The impact of the duration of the security on the calculation of the revised estimated cash flows.

The duration of a security 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 amortized cost exceeds fair value.

This factor provides an indication of how the contractual cash flows and effective interest rate of a financial asset compares with the implicit market estimate of cash flows and the risk attaching to a "fair value" measurement. The length of time for which that level of difference has been in place may also provide further evidence as to whether the market assessment implies an impairment loss has arisen.

The financial condition and prospects of the issuer or other observable conditions that indicate the investment may be impaired.

If a loss event that will have a detrimental effect on cash flows is identified an impairment loss in the income statement is recognized. The loss recognized 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 analyze cash flows begins with the current delinquency experience of the underlying collateral pool for the structure, by applying assumptions about how much of the currently delinquent loans will eventually default, and multiplying this by an assumed loss severity. Additional factors are applied to anticipate ageing effect. After applying a cash flow simulation an indication is obtained as to whether or not the security has suffered, or is anticipated to suffer, contractual principal or interest payment shortfall. If a shortfall applies an impairment charge is recorded.

The difference between the fair value and book cost for unimpaired securities accounted for as available-for-sale is accounted for as unrealized gains or losses, with the movements in the accounting period being accounted for in other comprehensive income.

Prudential'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, unrealized losses currently in equity may be recognized in the income statement in



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Included within the table above are amounts relating to sub-prime and Alt-A securities of:

Fair value of securities as a percentage of book value	2010		2009	
	Fair value	Unrealized loss	Fair value	Unrealized loss
	(£ million)			
Between 90 per cent and 100 per cent	98	(6)	102	(3)
Between 80 per cent and 90 per cent	55	(9)	160	(28)
Below 80 per cent <sup>note (d)</sup>	56	(25)	159	(88)
Total	209	(40)	421	(119)

(b) Unrealized losses by maturity of security

	2010 Unrealized loss	2009 Unrealized loss
	(£ million)	
Less than 1 year		
1 to 5 years	(6)	(29)
5 to ten years	(47)	(127)
More than ten years	(49)	(92)
Mortgage-backed and other debt securities	(268)	(718)
Total	(370)	(966)

(c) Age analysis of unrealized losses for the periods indicated

The following table shows the age analysis for all the unrealized losses in the portfolio by reference to the length of time the securities have been in an unrealized loss position:

Aged analysis of unrealized losses for the periods indicated	2010		2009			
	Non-investment grade	Investment grade	Non-investment grade	Investment grade	Total	
	(£ million)					
Less than 6 months	(3)	(67)	(70)	(7)	(51)	(58)
6 months to 1 year	(2)		(2)	(25)	(59)	(84)
1 year to 2 years	(13)	(20)	(33)	(59)	(234)	(293)
2 years to 3 years	(27)	(55)	(82)	(125)	(199)	(324)
More than 3 years	(58)	(125)	(183)	(35)	(172)	(207)
Total	(103)	(267)	(370)	(251)	(715)	(966)

At December 31, 2010, the gross unrealized losses in the statement of financial position for the sub-prime and Alt-A securities in an unrealized loss position were £40 million (2009: £119 million), as shown above in note (a). Of these losses £1 million (2009: £21 million) relate to securities that have been in an unrealized loss position for less than one year and £39 million (2009: £98 million) to securities that have been in an unrealized loss position for more than one year.

(d) Securities whose fair value was below 80 per cent of the book value

As shown in the table (a) above, £224 million, of the £370 million of gross unrealized losses at December 31, 2010 (2009: £594 million of the £966 million of gross unrealized losses), related to securities whose fair value was below 80 per cent of the book value. The analysis of the £224 million





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(2009: £594 million), by category of debt securities and by age analysis indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

Category analysis	2010		2009	
	Fair value	Unrealized Loss	Fair value	Unrealized Loss
	(£ million)			
Residential mortgage-backed securities				
Prime (including agency)	88	(39)	322	(153)
Alt-A	15	(4)	77	(33)
Sub-prime	41	(20)	82	(55)
	144	(63)	481	(241)
Commercial mortgage-backed securities	8	(29)	87	(86)
Other asset-backed securities	123	(105)	183	(188)
Total structured securities	275	(197)	751	(515)
Corporates	64	(27)	175	(79)
Total	339	(224)	926	(594)

Age analysis of fair value being below 80 per cent for the period indicated:

Age analysis	2010		2009	
	Fair value	Unrealized loss	Fair value	Unrealized loss
	(£ million)			
Less than 3 months		(1)	153	(45)
3 months to 6 months			5	(3)
More than 6 months	339	(223)	768	(546)
Total	339	(224)	926	(594)

## 2. Information regarding the position as at March 31, 2011

On May 11, 2011, Prudential published its first quarter 2011 Interim Management Statement with the UK Listing Authority. This statement included details on the financial position as at March 31, 2011 in relation to Jackson's available-for-sale securities as follows:

### Defaults, losses from sales of impaired and deteriorating bonds and write-downs for non-linked shareholder backed business

In general, the debt securities of Jackson are purchased with the intention and the ability to hold them for the longer-term.

The majority of Jackson's debt securities are classified as available-for-sale under IAS 39. Under this classification realized losses from defaults, sales of impaired and deteriorating bonds and write-downs are recorded in the income statement. Changes in unrealized appreciation and depreciation are recorded as a movement directly in other comprehensive income.

Jackson continues to review its investments on a case-by-case basis to determine whether any decline in fair value represents an impairment and therefore requiring an accounting write-down. IFRS requires available-for-sale debt securities which are impaired to be written down to fair value through income statement.

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The defaults, losses on sales of impaired and deteriorating bonds (net of recoveries) and write-downs for the three months to March 31, 2011 were as follows:

<b>Defaults</b>	<b>Bond write downs (£ million)</b>	<b>Losses on sales of impaired and deteriorating bonds (net of recoveries)</b>
Corporate debt securities		2
Residential mortgage backed securities		
Prime	5	
Alt-A	1	
Sub-prime		
Other		(4)
	6	(2)

In addition to the impairments on the debt securities portfolio, Jackson incurred impairments of £9 million on its commercial mortgage book.

Debt securities in an unrealized loss position

For Jackson's securities classified as available-for-sale under IAS 39, at March 31, 2011 there was a net unrealized gain position of £1,168 million. This amount comprised £1,478 million of gross unrealized gains and £310 million of gross unrealized losses on individual securities. Under IFRS unrealized losses are only applicable for securities which have not been impaired during the period. Securities impaired during the period are written down to fair value through the income statement in full. The table above shows the element of write downs in the first quarter of 2011. Included within the gross unrealized losses is £170 million for securities which are valued at less than 80 per cent of book value, of which eight per cent have been at this level for less than six months.

IFRS requires securities to be carried at fair value, being the amount for which the security would be exchanged between knowledgeable, willing parties in an arm's length transaction. The best evidence of fair value is quoted prices in an active market, but if the market is not active then a valuation technique is used to establish fair value.

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(a) Movements in the values for the three months to March 31, 2011:

Movements in the values of available-for-sale securities for the three months to March 31, 2011 are included in the table shown below:

	<b>Changes reflected directly in shareholders' equity</b>				
	<b>Quarter 1</b>				
	<b>March 31, 2011</b>	<b>Movement in Quarter 1</b>	<b>Foreign exchange translation* (£ million)</b>	<b>including foreign exchange</b>	<b>December 31, 2010</b>
<b>Assets fair valued at below book value</b>					
Book value	5,422	1,152	(102)	1,050	4,372
Unrealized loss	(310)	51	9	60	(370)
Fair value (as included in the balance sheet)	5,112	1,203	(93)	1,110	4,002
<b>Assets fair valued at or above book value</b>					
Book value	18,864	(1,396)	(483)	(1,879)	20,743
Unrealized gain	1,478	(66)	(36)	(102)	1,580
Fair value (as included in the balance sheet)	20,342	(1,462)	(519)	(1,981)	22,323
<b>Total</b>					
Book value	24,286	(244)	(585)	(829)	25,115
Net unrealized gain	1,168	(15)	(27)	(42)	1,210
Fair value (as included in the balance sheet)*	25,454	(259)	(612)	(871)	26,325

\*

Balance sheet items for Jackson National Life have been translated at the closing rate for the period, being \$1.60 at March 31, 2011. Jackson National Life income statement movements have been translated at the average exchange rate for the period, being \$1.62 for three months to March 31, 2011.

(b) Fair value of securities in an unrealized loss position as a percentage of book value:

(i) Fair value of securities as a percentage of book value:

The unrealized losses in the Jackson balance sheet on unimpaired securities at March 31, 2011 were £310 million (December 31, 2010: £370 million) relating to assets with fair market value and book value of £5,112 million (December 31, 2010: £4,002 million) and £5,422 million (December 31, 2010: £4,372 million), respectively.



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The following table shows the fair value of the securities in a gross unrealized loss position for various percentages of book value:

	<b>Fair value March 31, 2011</b>	<b>Unrealized loss March 31, 2011</b>	<b>Fair value December 31, 2010</b>	<b>Unrealized loss December 31, 2010</b>
	( <b>£ million</b> )			
Between 90 per cent and 100 per cent	4,630	(107)	3,390	(102)
Between 80 per cent and 90 per cent	203	(33)	273	(44)
Below 80 per cent	279	(170)	339	(224)
	5,112	(310)	4,002	(370)

(ii)

Fair value of sub-prime and Alt-A securities as a percentage of book value

Included within the table above are amounts relating to sub-prime and Alt-A securities in a gross unrealized loss position for various percentages of book value of:

	<b>Fair value March 31, 2011</b>	<b>Unrealized loss March 31, 2011</b>	<b>Fair value December 31, 2010</b>	<b>Unrealized loss December 31, 2010</b>
	( <b>£ million</b> )			
Between 90 per cent and 100 per cent	90	(4)	98	(6)
Between 80 per cent and 90 per cent	73	(12)	55	(9)
Below 80 per cent	47	(22)	56	(25)
	210	(38)	209	(40)

(c)

Securities whose fair value were below 80 per cent of the book value:

As shown in the table above, £170 million (December 31, 2010: £224 million) of the £310 million (December 31, 2010: £370 million) of gross unrealized losses at March 31, 2011 related to securities whose fair value were below 80 per cent of the book value. The age analysis for this £170 million (December 31, 2010: £224 million), indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

	<b>Fair value March 31, 2011</b>	<b>Unrealized loss March 31, 2011</b>	<b>Fair value December 31, 2010</b>	<b>Unrealized loss December 31, 2010</b>
	( <b>£ million</b> )			
Less than 3 months	27	(14)		(1)
3 months to 6 months				
More than 6 months	252	(156)	339	(223)
	279	(170)	339	(224)

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For securities valued at less than 80 per cent of book value, 78 per cent were investment grade. The analysis by category of debt securities whose fair value were below 80 per cent of the book value is as follows:

	<b>Fair value March 31, 2011</b>	<b>Unrealized loss March 31, 2011</b>	<b>Fair value December 31, 2010</b>	<b>Unrealized loss December 31, 2010</b>
( <b>£ million</b> )				
<b>RMBS</b>				
Prime	45	(20)	88	(39)
Alt-A	7	(3)	15	(4)
Sub-prime	40	(20)	41	(20)
	<b>92</b>	<b>(43)</b>	144	(63)
<b>Commercial mortgage backed securities</b>				
	9	(26)	8	(29)
<b>Other asset backed securities</b>				
	123	(79)	123	(105)
<b>Total structured securities</b>				
	224	(148)	275	(197)
<b>Corporates</b>				
	55	(22)	64	(27)
	<b>279</b>	<b>(170)</b>	339	(224)

Assets held at amortized cost

Financial assets classified as loans and receivables under IAS 39 are carried at amortized cost using the effective interest rate method. Certain mortgage loans of the UK insurance operations have been designated at fair value through profit and loss as this loan portfolio is managed and evaluated on a fair value basis and these are included within loans in the balance sheet. The loans and receivables include loans collateralized by mortgages, deposits and loans to policyholders. In estimating future cash flows, Prudential 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 Prudential may later decide to sell the asset as a result of changed circumstances.

**Insurance contracts***Product classification*

IFRS 4 requires contracts written by insurers to be classified as either "insurance contracts" or "investment contracts" depending on the level of insurance risk transferred. Insurance risk is a pre-existing risk, other than financial risk, transferred from the contract holder to the contract issuer. If significant insurance risk is transferred by the contract then it is classified as an insurance contract. Contracts that transfer financial risk but not significant insurance risk are termed investment contracts. Furthermore, some contracts, both insurance and investment, contain discretionary participating features representing the contractual right to receive additional benefits as a supplement to guaranteed benefits:

- (a) that are likely to be a significant portion of the total contract benefits;
- (b) whose amount or timing is contractually at the discretion of the insurer; and





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- (c) that are contractually based on asset or fund performance, as discussed in IFRS 4.

Accordingly, insurers must perform a product classification exercise across their portfolio of contracts issued to determine the allocation to these various categories. IFRS 4 permits the continued usage of previously applied GAAP for insurance contracts and investment contracts with discretionary participating features. Except for UK regulated with-profits funds, as described subsequently, this basis has been applied by Prudential.

For investment contracts that do not contain discretionary participating features, IAS 39 and, where the contract includes an investment management element, IAS 18, apply measurement principles to assets and liabilities attaching to the contract.

***Valuation assumptions***

***(i) Contracts of with-profits funds***

Prudential's insurance contracts and investment contracts with discretionary participating features are primarily with-profits and other protection type policies. For UK regulated with-profits funds, the contract liabilities are valued by reference to the UK FSA realistic basis. In aggregate, this basis has the effect of placing a value on the liabilities of UK with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances.

The basis of determining liabilities for Prudential's with-profits business has little or no effect on the results attributable to shareholders. This is because movements on liabilities of the with-profits funds are absorbed by the unallocated surplus. Except through indirect effects, or in remote circumstances as described below, changes to liability assumptions are therefore reflected in the carrying value of the unallocated surplus, which is accounted for as a liability rather than shareholders' equity.

A detailed explanation of the basis of liability measurement is contained in note D2(g)(ii) to the consolidated financial statements in Item 18. Prudential's other with-profits contracts are written in with-profits funds that operate in some of Prudential's Asian operations. The liabilities for these contracts and those of Prudential Annuities Limited, which is a subsidiary company of the PAC with-profits funds, are determined differently. For these 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.

For liabilities determined using the basis described above for UK regulated with-profits funds, and the other liabilities described in the preceding paragraph, changes in estimates arising from the likely range of possible changes in underlying key assumptions have no direct impact on the reported profit.

This lack of sensitivity reflects the with-profits fund structure, basis of distribution, and the application of previous GAAP to the unallocated surplus of with-profits funds as permitted by IFRS 4. Changes in liabilities of these contracts that are caused by altered estimates are absorbed by the unallocated surplus of the with-profits funds with no direct effect on shareholders' equity. Prudential's obligations and more detail on such circumstances are described in note H14 to the consolidated financial statements in Item 18.

***(ii) Other contracts***

Contracts, other than those of with-profits funds, are written in shareholder-backed operations of Prudential. 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

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between business units. For some types of business the effect of changes in assumptions may be significant, whilst for others, due to the nature of the product, assumption setting may be of less significance. The nature of the products and the significance of assumptions are discussed in notes D2, D3 and D4 to the consolidated financial statements in Item 18. From the perspective of shareholder results the key sensitivity relates to the assumption for allowance for credit risk for UK annuity business.

*Jackson*

Jackson offers individual fixed annuities, fixed index annuities, immediate annuities, variable annuities, individual and variable life insurance and institutional products. With the exception of institutional products and an incidental amount of business for annuity certain contracts, which are accounted for as investment contracts under IAS 39, all of Jackson's contracts are accounted for under IFRS 4 as insurance contracts by applying US GAAP, the previous GAAP used before IFRS adoption. The accounting requirements under these standards and the effect of changes in valuation assumptions are considered below for fixed annuity, variable annuity and traditional life insurance contracts.

Fixed annuity contracts, which are investment contracts under US GAAP terminology, are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts, namely deferred income, any amounts previously assessed against policyholders that are refundable on termination of the contract, and any premium deficiency, i.e. any probable future loss on the contract. These types of 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 variable annuity business, the key assumption is the expected long-term level of equity market returns, which for all years included 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) to 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 amortization of deferred acquisition costs as described below and the required level of provision for guaranteed minimum death benefit claims.

For traditional life insurance contracts, provisions for future policy benefits are determined using the net level premium method and assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviation.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and the guaranteed minimum death benefit reserves, the profits of Jackson are relatively insensitive to changes in insurance risk. This reflects the principally spread and fee-based nature of Jackson's business.

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*Asian operations*

The insurance products written in Prudential's Asian operations principally cover with-profits business, unit-linked business, and other non-participating business. The results of with-profits business are relatively insensitive to changes in estimates and assumptions that affect the measurement of policyholder liabilities. As for the UK business, this feature arises because unallocated surplus is accounted for by Prudential as a liability. The results of Asian unit-linked business are also relatively insensitive to changes in estimates or assumptions.

The remaining non-participating business in Asia has some limited sensitivity to interest rates. Further details are provided in note D4(j) to the consolidated financial statements in Item 18.

**Deferred acquisition costs**

Significant costs are incurred in connection with acquiring new insurance business. Except for acquisition costs of with-profits contracts of the UK regulated with-profits funds, which are accounted for under the realistic FSA regime as described in note A4 to the consolidated financial statements in Item 18, these costs, which vary with, and are primarily related to, the production of new business, are capitalized and amortized against margins in future revenues on the related insurance policies. The recoverability of the asset is measured and the asset is deemed impaired if the projected future margins are less than the carrying value of the asset. To the extent that the future margins differ from those anticipated, then an adjustment to the carrying value of the deferred acquisition cost asset will be necessary.

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

***Jackson***

For term business, acquisition costs are deferred and amortized in line with expected premiums. For annuity business, acquisition costs are deferred and amortized in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the long-term spread between the earned rate and the rate credited to policyholders, which is based on the annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all of which are based on a combination of Jackson's actual industry experience and future expectations. A detailed analysis of actual experience is measured by internally developed mortality studies.

For variable annuity business, the key assumption is the expected long-term level of equity market returns as described above.

The level of acquisition costs carried in the statement of financial position is also sensitive to unrealized 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.

***Asian operations***

For those territories applying US GAAP, principles similar to those set out in the Jackson paragraph above are applied to the deferral and amortization of acquisition costs. For other Asian territories, except where the underlying reserving basis makes implicit allowance for the future fees that cover acquisition costs, the deferral and amortization of acquisition costs is consistent with Modified Statutory Basis where costs associated with the production of new business are amortized in line with the emergence of margins.

Table of Contents**Pensions**

Prudential applies the requirements of IAS 19, "Employee Benefits" and associated interpretations including IFRIC 14 "IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction", to its defined benefit pension schemes. The principal defined benefit pension scheme is the Prudential Staff Pension Scheme ("PSPS"). For PSPS the terms of the trust deed restrict shareholders' access to any underlying surplus. Accordingly, applying the interpretation of IFRIC 14, any underlying IAS 19 basis surplus is not recognized for IFRS reporting.

The financial position for PSPS recorded in the IFRS financial statements reflects the higher of any underlying IAS 19 deficit and any obligation for deficit funding.

The economic participation in the surplus or deficits attaching to the PSPS and the smaller Scottish Amicable Pensions Scheme ("SAPS") are shared between the PAC with-profits sub-fund ("WPSF") and shareholder operations. The economic interest reflects the source of contributions over the scheme life, which in turn reflects the activity of the members during their employment.

In the case of PSPS, movements in the apportionment of the financial position for PSPS between the WPSF and shareholders' funds in 2010 reflect the  $^{70}/_{30}$  ratio applied to the base deficit position as at December 31, 2005 but with service cost and contributions for ongoing service apportioned by reference to the cost allocation for activity of current employees. For SAPS, the ratio is estimated to be approximately 50/50 between the WPSF and shareholders' funds.

Due to the inclusion of actuarial gains and losses in the income statement rather than being recognized in other comprehensive income, the results of Prudential are affected by changes in interest rates for corporate bonds that affect the rate applied to discount projected pension payments, changes in mortality assumptions and changes in inflation assumptions.

The table below shows the sensitivity of the underlying PSPS, Scottish Amicable and M&G pension scheme liabilities as at December 31, 2010 of £4,866 million, £572 million and £254 million respectively to changes in discount rates, inflation rates and mortality rate assumptions.

Assumption	Change in assumption	2010	
		Impact on scheme liabilities on IAS 19 basis	
Discount rate	Decrease by 0.2% from 5.45% to 5.25%	Increase in scheme liabilities by:	
		PSPS	3.6%
		Scottish Amicable	5.2%
Discount rate	Increase by 0.2% from 5.45% to 5.65%	Decrease in scheme liabilities by:	
		PSPS	3.5%
		Scottish Amicable	4.9%
Rate of inflation	Decrease by 0.2% from 3.55% to 3.35% with consequent reduction in salary increases	Decrease in scheme liabilities by:	
		PSPS	1.0%
		Scottish Amicable	5.0%
Mortality rate	Increase life expectancy by one year	Increase in scheme liabilities by:	
		PSPS	2.1%
		Scottish Amicable	2.5%
		M&G	2.9%

The sensitivity of the underlying pension scheme liabilities to changes in discount rates and inflation rates as shown above does not directly equate to an impact on the profit or loss attributable to

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shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund. Further information is included in note I3 of the consolidated financial information in Item 18.

For PSPS, the underlying surplus of the scheme of £485 million (2009: £513 million), as at December 31, 2010 and 2009, has not been recognized under IFRIC 14. Any change in the underlying scheme liabilities to the extent that it is not sufficient to alter PSPS into a liability in excess of the deficit provision, will not have an impact on Prudential's results and financial position. Based on the underlying financial position of PSPS as at December 31, 2010, none of the changes to the underlying scheme liabilities for the changes in the variables shown in the table above have had an impact on the Group's 2010 results and financial position.

In the event that a change in the PSPS scheme liabilities results in a deficit position for the scheme which is recognizable, the deficit recognized affects Prudential's results and financial position only to the extent of the amounts attributable to shareholder operations. The amounts attributable to the PAC with-profits fund are absorbed by the liability for unallocated surplus and have no direct effect on the profit or loss attributable to shareholders or shareholders' equity.

The deficit of the Scottish Amicable scheme has been allocated 50 per cent to the PAC with-profits fund and 50 per cent to the PAC shareholders fund. Accordingly, half of the changes to the scheme liabilities for the changes in the variables shown in the table above would have had an impact on the Group's shareholder results and financial position. The M&G pension scheme is wholly attributable to shareholders.

**Deferred tax**

Deferred tax assets are recognized to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The taxation regimes applicable across the Group apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets. The judgments made, and uncertainties considered, in arriving at deferred tax balances in the financial statements are discussed in note H4 to Prudential's consolidated financial statements in Item 18.

**Goodwill**

Goodwill impairment testing requires the exercise of judgment by management as to prospective future cash flows. Further information is disclosed in note H1 to the consolidated financial statements in Item 18.

**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 Prudential's life assurance business are classified as insurance contracts and investment contracts with discretionary participating features. As permitted by

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IFRS 4, assets and liabilities of these contracts (see below) 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") has been applied.

In 2005, Prudential chose to improve its IFRS accounting for UK regulated with-profits funds by the voluntary application of the UK accounting standard FRS 27, "Life Assurance". Under this standard, the main accounting changes that were required for UK with-profits funds were:

derecognition of deferred acquisition costs and related deferred tax; and

replacement of MSB liabilities with adjusted realistic basis liabilities.

The results included in the consolidated financial statements in Item 18 reflect this basis.

Unallocated surplus represents the excess of assets over policyholder liabilities for Prudential's with-profits funds that have yet to be appropriated between policyholders and shareholders. Prudential has opted to account for unallocated surplus wholly as a liability with no allocation to equity.

This treatment reflects the fact that shareholders' participation in the cost of bonuses arises only on distribution. Shareholder profits on with-profits business reflect one-ninth of the cost of declared bonus.

For 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 Taiwan, Vietnam and Japan, countries where local GAAP is not appropriate in the context of the previously applied MSB, accounting for insurance contracts is based on US GAAP. For participating business the liabilities include provisions for the policyholders' interest in realized investment gains and other surpluses that, where appropriate, and in particular for Vietnam, have yet to be declared as bonuses.

The usage of these bases of accounting has varying effects on the way in which product options and guarantees are measured. For UK regulated with-profits funds, options and guarantees are valued on a market consistent basis. The basis is described in note D2(g)(ii) 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 A4 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.

**Valuation and accounting presentation of fair value movements of derivatives and debt securities of Jackson**

Under IAS 39, derivatives are required to be carried at fair value. Unless net investment hedge accounting is applied, value movements on derivatives are recognized in the income statement. Prudential has chosen to change its presentation of operating profit based on longer-term investment returns for its US insurance operations, within the supplementary analysis of profit, as explained further below under the section "(c) Additional explanation of performance measures and analysis of consolidated results by business segment and geographical region" and also in note A4(d)(ii) to the consolidated financial statements in Item 18. Derivative value movements in respect of equity risk for variable annuity business and other equity related hedging activities are now excluded from operating profit based on longer-term investment returns and included as part of short-term fluctuations in investment returns. Accordingly the value movements on all derivatives held by Jackson are separately identified within the short-term fluctuations in investment returns identified as part of Prudential's segment results described below and in note B1 to the consolidated financial statements in Item 18.

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For derivative instruments of Jackson, Prudential has considered whether it is appropriate to undertake the necessary operational changes to qualify for hedge accounting so as to achieve matching of value movements in hedging instruments and hedged items in the performance statements. In reaching the decision a number of factors were particularly relevant.

These were:

IAS 39 hedging criteria have been designed primarily in the context of hedging and hedging instruments that are assessable as financial instruments that are either stand-alone or separable from host contracts, rather than, for example, duration characteristics of insurance contracts;

the high hurdle levels under IAS 39 of ensuring hedge effectiveness at the level of individual hedge transactions;

the difficulties in applying the macro hedge provisions under IAS 39 (which are more suited to banking arrangements) to Jackson's derivative book;

the complexity of asset and liability matching of US life insurers such as those with Jackson's product range; and finally

whether it is possible or desirable, without an unacceptable level of costs and constraint on commercial activity, to achieve the accounting hedge effectiveness required under IAS 39.

Taking account of these considerations Prudential has decided that, except for certain minor categories of derivatives, it is not appropriate to seek to achieve hedge accounting under IAS 39. As a result of this decision, the total income statement results are more volatile as the movements in the value of Jackson's derivatives are reflected within it.

Under IAS 39, unless carried at amortized cost (subject to impairment provisions where appropriate) under the held-to-maturity category, debt securities are also carried at fair value. Prudential 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 Prudential 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.

However, pre-tax profits are determined after transfers to or from unallocated surplus of with-profits funds. These transfers are in turn determined after taking account of tax borne by with-profits funds. Consequently, reported profit before the total tax charge is not representative of pre-tax profits attributable to shareholders. In order to provide a measure of pre-tax profits attributable to shareholders Prudential 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**

Prudential uses operating profit based on longer-term investment returns as the segmental measure of its results. The basis of calculation is disclosed in the paragraph in this 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".

For shareholder-backed business, with the exception of debt securities held by Jackson and the majority of assets classified as loans and receivables, all financial investments and investment property are designated as assets at fair value through profit and loss. Short-term fluctuations in investment





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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. However, for shareholder-backed businesses the short-term fluctuations affect the result for the year and Prudential provides additional analysis of results to provide information on results before and after short-term fluctuations in investment returns.

**Summary Consolidated Results and Basis of Preparation of Analysis**

The following table shows Prudential's consolidated total profit (loss) for the years indicated.

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Total revenue, net of reinsurance	<b>47,646</b>	48,099	(10,267)
Total charges, net of reinsurance	<b>(45,574)</b>	(46,535)	8,193
Profit (loss) before tax <i>(being tax attributable to shareholders' and policyholders' returns)*</i>	<b>2,072</b>	1,564	(2,074)
Tax attributable to policyholders' returns	<b>(611)</b>	(818)	1,624
Profit (loss) before tax attributable to shareholders	<b>1,461</b>	746	(450)
Tax (charge)/credit	<b>(636)</b>	(873)	1,683
Less: tax attributable to policyholders' returns	<b>611</b>	818	(1,624)
Tax (charge)/credit attributable to shareholders' returns	<b>(25)</b>	(55)	59
Profit (loss) from continuing operations after tax	<b>1,436</b>	691	(391)
Discontinued operations (net of tax)		(14)	
Profit (loss) for the year	<b>1,436</b>	677	(391)

\*

This measure is the formal loss before tax measure under IFRS but it is not the result 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.



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**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 2010 was £1,436 million compared to £677 million for 2009. The increase of £759 million predominantly reflects movement in results from continuing operations after tax, which has improved from £691 million in 2009 to £1,436 million in 2010 and a loss from discontinued operations in 2009 of £14 million.

The increase in profit from continuing operations after tax reflects an increase in profits before tax attributable to shareholders of £715 million, from a profit of £746 million in 2009 to £1,461 million in 2010 and a decrease in the tax charge attributable to shareholders of £30 million, from a £55 million charge in 2009 to a £25 million charge in 2010. The effective tax rate for 2010 was two per cent, compared to an effective tax rate of seven per cent for 2009. Further details are provided in note F5 to the consolidated financial statements in Item 18.

The total profit before tax from continuing operations attributable to shareholders was £1,461 million in 2010, compared with £746 million in 2009. The improvement reflects the increase in operating profit based on longer-term investment returns and the impact of one-off items. The profit in 2010 was reduced by the terminated AIA transaction costs of £377 million, whereas 2009 was adversely impacted by the £621 million loss recorded as part of the disposal of the Taiwan Agency business and IGD hedge costs of £235 million.

The £677 million profit for the year after tax for 2009 compared to a £391 million loss for 2008. This £1,068 million increase reflected a movement in results from continuing operations after tax, which improved from a loss of £391 million in 2008 to a profit of £691 million in 2009, and a loss from discontinued operations of £14 million.

The increase in profit from continuing operations after tax reflected an increase in profits before tax attributable to shareholders of £1,196 million, from a loss of £450 million in 2008 to a profit of £746 million in 2009, partially offset by a £114 million increase in the tax charge attributable to shareholders, which increased from a £59 million credit in 2008 to a £55 million charge in 2009. The effective tax rate for 2009 was seven per cent, compared to an effective tax rate of 13 per cent for 2008. Further details are provided in note F5 to the consolidated financial statements in Item 18.

The movement in profit before tax attributable to shareholders primarily reflected improvements in three aspects of the Group's retained business (i.e., excluding the Taiwan agency business that was sold in June 2009, but including the retained bank distribution business), namely a £1,757 million improvement in short-term fluctuations in investment returns, an increase in the charge of £61 million in the level of actuarial and other gains and losses on the Group's defined benefit pension schemes and a £122 million increase in operating profit based on longer-term investment returns, which was partially offset by an increase of £622 million in losses in respect of the Taiwan agency business which was sold in June 2009 from a £1 million profit in the results in 2008 to a £621 million loss on sale and results up to the date of sale in 2009. These movements are discussed in detail in section (c) below.

**(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, the Asian asset management business and the US broker-dealer and asset management business (including Curian).

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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.

<b>Year Ended December 31, 2010</b>					
	<b>Asia</b>	<b>US</b>	<b>UK</b>	<b>Unallocated corporate</b>	<b>Total</b>
	<b>(£ million)</b>				
Insurance operations	580	338	646		1,564
Asset management**	57	13	237		307
<b>Total (loss) profit attributable to the segments</b>	<b>637</b>	<b>351</b>	<b>883</b>		<b>1,871</b>
Unallocated corporate***				(435)	(435)
<b>Total (loss) profit for the year</b>	<b>637</b>	<b>351</b>	<b>883</b>	<b>(435)</b>	<b>1,436</b>

<b>Year Ended December 31, 2009</b>					
	<b>Asia</b>	<b>US</b>	<b>UK</b>	<b>Unallocated corporate</b>	<b>Total</b>
	<b>(£ million)</b>				
Insurance operations	(218)*	588	489		859
Asset management**	42	3	219		264
<b>Total profit attributable to the segments</b>	<b>(176)</b>	<b>591</b>	<b>708</b>		<b>1,123</b>
Unallocated corporate***				(432)	(432)
Discontinued operations****				(14)	(14)
<b>Total profit (loss) for the year</b>	<b>(176)</b>	<b>591</b>	<b>708</b>	<b>(446)</b>	<b>677</b>

<b>Year Ended December 31, 2008</b>					
	<b>Asia</b>	<b>US</b>	<b>UK</b>	<b>Unallocated corporate</b>	<b>Total</b>
	<b>(£ million)</b>				
Insurance operations	19	(580)	320		(241)
Asset management**	39	1	55		95
<b>Total profit attributable to the segments</b>	<b>58</b>	<b>(579)</b>	<b>375</b>		<b>(146)</b>
Unallocated corporate				(245)	(245)
<b>Total (loss) profit for the year</b>	<b>58</b>	<b>(579)</b>	<b>375</b>	<b>(245)</b>	<b>(391)</b>

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\*

Includes the loss on the sale of the Taiwan agency business of £559 million. Excluding this amount, the total profit for the period for Asian insurance operations would be £341 million.

\*\*

For the US, including the broker dealer business and Curian.

\*\*\*

The results for unallocated corporate for the year ended December 31, 2010 and 2009 include the impacts of the costs of the terminated AIA transaction and the IGD hedging respectively.

\*\*\*\*

Additional information on discontinued operations is set out in note I10 to the consolidated financial statements in Item 18.

*Profit from insurance operations*

Total profit from insurance operations in 2010 was £1,564 million compared to £859 million in 2009 and a loss of £241 million in 2008. All of the profits from insurance operations in 2010, 2009 and 2008 were from continuing operations. The 2009 figure includes the loss on sale of £559 million for the Taiwan agency business, the disposal of which was completed in June 2009 but did not qualify as a

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discontinued operation under IFRS. The movement in profits for insurance operations can be summarized as follows:

	<b>Year Ended</b>		
	<b>December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Profit before shareholder tax	<b>1,961</b>	1,025	(183)
Shareholder tax	<b>(397)</b>	(166)	(58)
<b>Profit (loss) after tax</b>	<b>1,564</b>	859	(241)

The increase of £936 million in profit before tax attributable to shareholders in 2010 compared to 2009 primarily reflects an increase in operating profits based on longer term investment returns and the results of 2009 being impacted by the loss on sale of the Taiwan agency business of £559 million. The increase over 2009 resulting from these factors was partially offset by a negative movement in short term fluctuations in investment returns.

The increase of £1,208 million in profit before tax attributable to shareholders in 2009 compared to 2008 primarily reflects positive short-term fluctuations in investment returns and an increase in operating profit based on longer-term investment returns of the insurance operations, partially offset by the loss on sale of the Taiwan agency business.

The effective shareholder tax rate on profits from insurance operations increased from 16 per cent in 2009 to 20 per cent in 2010. This was due to a number of factors including:

In the US, the 2009 rate was unusually low as it reflected the reversal of the valuation allowance set up in 2008 in respect of carried forward losses.

This was partly offset by:

In Asia, the 2009 tax rate being adversely affected as there was no tax relief on the loss relating to the sale of the Taiwan agency business.

In the UK, favorable routine revisions to prior period tax returns in 2010.

The effective shareholder tax rate on profits from insurance operations changed from a negative 32 per cent in 2008 to 16 per cent in 2009. This was due to a number of factors including:

In the US, the 2008 rate being adversely affected by the inability to fully recognize deferred tax assets on losses with the valuation allowance then being reversed in 2009.

In Asia, the 2008 rate being adversely affected by the inability to recognize losses in several jurisdictions which were not expected to be available for relief against future profits along with there being no tax relief in 2009 on the loss relating to the sale of the Taiwan agency business.

In the UK, the 2008 rate being lower than expected due to the settlement of outstanding issues with HMRC at an amount below that previously provided offset by adjustments in respect of the prior year tax charge.

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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.

Table of Contents**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 Asian operations in countries where local GAAP is not well established and in which the business is primarily non-participating and linked business, US GAAP is used as the most appropriate reporting basis. This basis is applied in Japan and Vietnam, and less materially following the sale of the agency business in 2009, in Taiwan. 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" section below.

***Comparison of total profit (loss) arising from Asian insurance operations***

The following table shows the movement in profit/(loss) arising from Asian insurance operations for 2010, 2009 and 2008:

	<b>Year Ended</b>		
	<b>December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Profit/(loss) before shareholder tax	<b>646</b>	(180)	92
Shareholder tax	<b>(66)</b>	(38)	(73)
Profit/(loss) after tax	<b>580</b>	(218)	19

The 2010 profit before tax attributable to shareholders of £646 million represented an increase of £826 million over the loss incurred in 2009 of £180 million. The increase was primarily due to the one-off loss in 2009 of £559 million, arising on the sale of the Taiwan agency business completed in June 2009; an increase in operating profit based on longer-term investment returns of £122 million in 2010 over 2009 and a positive change in short term fluctuations in investment returns of £83 million.

The effective shareholder tax rate changed from negative 21 per cent in 2009 to 10 per cent in 2010 principally due to there being no tax relief on the loss relating to the sale of the Taiwan agency business in June 2009.

The 2009 loss before tax attributable to shareholders of £180 million represented a decrease of £272 million over the profit incurred in 2008 of £192 million. The decrease was primarily due to the losses relating to the sale and the trading results of the Taiwan agency business in 2009, partially offset by a positive change of £169 million in the short-term fluctuations in investment returns for shareholder-backed business and an increase of £179 million in operating profit based on longer-term investment returns.

A one off credit of £63 million arose in 2009 as a result of replacing the methodology for valuing the liabilities of the Malaysia life business by a method based on the Malaysian authority's risk based capital framework on January 1, 2009.

The effective shareholder tax rate changed from 79 per cent in 2008 to negative 21 per cent in 2009. This is primarily due to the inability to obtain tax relief on the loss relating to the sale of the Taiwan agency business in 2009 and in 2008 the inability to recognize losses in several jurisdictions which were not expected to be available for relief against future profits.



Table of Contents**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, 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 (loss) arising from US insurance operations*

The following table shows the movement in profits/(loss) arising from US insurance operations for 2010, 2009 and 2008:

	<b>Year Ended</b>		
	<b>December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Profit (loss) before shareholder tax	455	486	(652)
Shareholder tax	(117)	102	72
Profit (loss) after tax	338	588	(580)

The decrease in profit before tax attributable to shareholders of £31 million for 2010 compared to 2009 was due to a negative change of £246 million in the short-term fluctuations in investment returns reflected in the income statement, partially offset by an increase of £215 million in operating profit based on longer-term investment returns. The increase in operating profit based on longer-term investment returns was primarily due to higher separate account fee income and higher spread income in 2010 compared to 2009. The negative change of £246 million in the short-term fluctuations in investment returns includes the movements relating to the US operations' derivative and embedded derivative value movements which changed from a negative net equity hedge accounting effect of £159 million in 2009 to a negative £367 million in 2010. See section "(c) Additional explanation of performance measures and analysis of consolidated results by business segment and geographical region" below for explanation of the amendment made by the Group in 2010 of the presentation of this net equity hedge accounting effect in its supplementary analysis of profit.

The effective tax rate on profit/(loss) from US operations changed from a negative 21 per cent in 2009 to a 26 per cent in 2010. The change was due to the 2009 rate having reflected the reversal of the valuation allowance set up in 2008 in respect of carried forward losses and thus being negative.

Of the £1,138 million increase in profit before tax attributable to shareholders for 2009 compared to 2008, the main driver was a positive change of £855 million in the short-term fluctuations in investment returns reflected in the income statement, and an increase of £283 million in operating profit based on longer-term investment returns. This increase in operating profit on longer-term investment returns was primarily from the effect of favorable exchange rate movements, increased operating profits from the fixed and fixed indexed annuity business and lower DAC amortization on variable annuity business as compared to 2008.

The effective tax rate on profit/(loss) from US operations changed from 11 per cent in 2008 to a negative 21 per cent in 2009. The change was due to the reversal in 2009 of the valuation allowance set up in 2008 in respect of carried forward losses.

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**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 December 31, 2010, liabilities to with-profits policyholders were in aggregate of £59.5 billion. Liabilities to with-profits policyholders in Asia as at December 31, 2010 were £11.0 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.

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.

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When target bonus levels change, the PAC board of directors has regard to the overall strength of the long-term fund when determining the length of time over which it will seek to achieve the amended prudent target bonus level.

In normal investment conditions, PAC expects changes in regular bonus rates to be gradual over time, and these are not expected to exceed one per cent per annum over any year. However, the directors of PAC retain the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

Final bonus rates

A final bonus, which is normally declared yearly, may be added when a claim is paid or when units of a unitized product are realized.

The rates of final bonus usually vary by type of policy and by reference to the period, usually a year, in which the policy commences or each premium is paid. These rates are determined by reference to the asset shares for the sample policies but subject to the smoothing approach, explained below.

In general, the same final bonus scale applies to maturity, death and surrender claims except that:

The total surrender value may be impacted by the application of a Market Value Reduction ("MVR") (for accumulating with-profits policies) and is affected by the surrender bases (for conventional with-profits business); and

For the Scottish Amicable Insurance Fund ("SAIF") and Scottish Amicable Life ("SAL"), the final bonus rates applicable on surrender may be adjusted to reflect expected future bonus rates.

Application of significant judgment

The application of the above method for determining bonuses requires the PAC board of directors to apply significant judgment in many respects, including in particular the following:

Determining what constitutes fair treatment of customers: Prudential is required by UK law and regulation to consider the fair treatment of its customers in setting bonus levels. The concept of determining what constitutes fair treatment, while established by statute, is not defined.

Smoothing of investment returns: Smoothing of investment returns is an important feature of with-profits products. Determining when particular circumstances, such as a significant rise or fall in market values, warrant variations in the standard bonus smoothing limits that apply in normal circumstances requires the PAC Board to exercise significant judgment.

Determining at what level to set bonuses to ensure that they are competitive: The overall return to policyholders is an important competitive measure for attracting new business.

Key assumptions

As noted above, the overall rate of return on investments and the expectation of future investment returns are the most important influences in bonus rates, subject to the smoothing described below. Prudential determines the assumptions to apply in respect of these factors, including the effects of reasonably likely changes in key assumptions, in the context of the overarching discretionary and smoothing framework that applies to its with-profits business as described above. As such, it is not possible to quantify specifically the effects of each of these assumptions or of reasonably likely changes in these assumptions.

Prudential's approach, in applying significant judgment 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



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that carry out a with-profits business to define, and make publicly available, the Principles and Practices of Financial Management ("PPFM") that are applied in the management of their with-profits funds.

Accordingly, Prudential's PPFM contains an explanation of how it determines regular and final bonus rates within the discretionary framework that applies to all with-profits policies, subject to the general legislative requirements applicable. The purpose of Prudential's PPFM is therefore to:

explain the nature and extent of the discretion available;

show how competing or conflicting interests or expectations of:

different groups and generations of policyholders, and

policyholders and shareholders are managed so that all policyholders and shareholders are treated fairly; and

provide a knowledgeable observer (e.g. a financial adviser) with an understanding of the material risks and rewards from starting and continuing to invest in a with-profits policy with Prudential.

Furthermore, in accordance with industry-wide regulatory requirements, the PAC Board has appointed:

an Actuarial Function Holder who provides the PAC board of directors with all actuarial advice;

a With-Profits Actuary whose specific duty is to advise the PAC board of directors on the reasonableness and proportionality of the manner in which its discretion has been exercised in applying the PPFM and the manner in which any conflicting interests have been addressed; and

a With-Profits Committee of independent individuals, which assesses the degree of compliance with the PPFM and the manner in which conflicting rights have been addressed.

Smoothing of investment return

In determining bonus rates for the UK with-profits policies, smoothing is applied to the allocation of the overall earnings of the UK with-profits fund of which the investment return is a significant element. The smoothing approach differs between accumulating and conventional with-profits policies to reflect the different contract features. In normal circumstances, Prudential does not expect most payout values on policies of the same duration to change by more than 10 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 of directors may decide to vary the standard bonus smoothing limits in order to protect the overall interests of policyholders.

The degree of smoothing is illustrated numerically by comparing in the following table the relatively "smoothed" level of policyholder bonuses declared as part of the surplus for distribution with the more

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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.

	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
<b>Net income of the fund:</b>			
Investment return	<b>8,815</b>	10,461	(14,595)
Claims incurred	<b>(6,390)</b>	(6,253)	(7,068)
Movement in policyholder liabilities	<b>(4,301)</b>	(3,692)	13,504
Add back policyholder bonuses for the year (as shown below)	<b>2,019</b>	1,827	2,565
Claims incurred and movement in policyholder liabilities (including charge for provision for asset shares and excluding policyholder bonuses)			
	<b>(8,672)</b>	(8,118)	9,001
Earned premiums, net of reinsurance	<b>3,148</b>	3,063	2,927
Other income	<b>9</b>	(2)	(36)
Acquisition costs and other operating expenditure	<b>(600)</b>	(842)	(408)
Tax (charge) credit	<b>(528)</b>	(640)	1,191
<b>Net income of the fund before movement in unallocated surplus</b>	<b>2,172</b>	3,922	(1,920)
Movement in unallocated surplus	<b>70</b>	(1,893)	4,769
<b>Surplus for distribution</b>	<b>2,242</b>	2,029	2,849
Surplus for distribution allocated as follows:			
90 per cent policyholders bonus (as shown above)	<b>2,019</b>	1,827	2,565
10 per cent shareholders' transfers	<b>223</b>	202	284
<b>Total</b>	<b>2,242</b>	2,029	2,849

***Unallocated surplus***

The unallocated surplus represents the excess of assets over policyholder liabilities for Prudential's with-profits funds. As allowed under IFRS 4, Prudential 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 unrealized 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 recognized 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.

Table of Contents*Comparison of total profit arising from UK insurance operations*

Profit after tax from UK insurance operations increased by £157 million from £489 million in 2009 to £646 million in 2010:

The following table shows the movement in profits arising from UK insurance operations for 2010, 2009 and 2008:

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Profit before shareholder tax	<b>860</b>	719	377
Shareholder tax	<b>(214)</b>	(230)	(57)
<b>Profit after tax</b>	<b>646</b>	489	320

The increase in 2010 in profit before tax attributable to shareholders of £141 million primarily reflects the increase in operating profit based on longer-term investment returns of £62 million, a small positive change in short-term fluctuations in investment returns of £8 million and a decrease in shareholders' share of actuarial losses on defined benefit pension scheme of £41 million. In addition, a gain of £30 million was 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 improvement in the operating profit based on longer-term investment returns compared to 2009 reflects the benefit of cost saving initiatives, higher with-profits income and increased annuity profits.

The effective shareholder tax rate on profits from UK insurance operations for 2010 of 25 per cent compared with the effective tax rate of 32 per cent in 2009 was due to favorable routine revisions to prior period tax returns in 2010.

The increase in 2009 in profit before tax attributable to shareholders of £342 million primarily reflects an increase in operating profit based on longer-term investment returns of £68 million and a positive change in the value of short-term fluctuations in investment returns of the shareholder-backed business of £320 million partially offset by an increase in shareholders' share of actuarial losses on defined benefit pension scheme of £46 million. The increase in the operating profit based on longer-term investment returns resulted from growth in the shareholder-backed annuity business, partially offset by a reduction in profits attributable to the with-profits business. The reduction in profits attributable to with-profits business reflected the impact of bonus rate reductions in the February 2009 bonus declaration made in response to recent volatile investment performance. Operating profit based on longer-term investment returns in 2009 included general insurance commission of £51 million compared with £44 million for 2008.

The effective shareholder tax rate on profits from UK insurance operations for 2009 of 32 per cent compared with the effective tax rate of 15 per cent in 2008 was due to the settlement in 2008 of some outstanding issues with HMRC at an amount below that previously provided.



Table of Contents**Profit from asset management**

Total profit from asset management increased from £353 million in 2009 to £420 million in 2010. The following table shows the movement in profits from asset management for 2010, 2009 and 2008:

	<b>Year Ended</b>		
	<b>December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Profit before shareholder tax	<b>420</b>	353	140
Shareholder tax	<b>(113)</b>	(89)	(45)
<b>Profit after tax</b>	<b>307</b>	264	95

The £67 million increase from 2009 to 2010 in profit before tax attributable to shareholders resulted primarily from an increase in profit generated by M&G, which increased from a profit before tax of £294 million in 2009 to a profit before tax of £326 million in 2010. The Group's profit before shareholder tax for the Asian asset management operations increased by £17 million and for the US broker-dealer and asset management operations increased by £18 million from 2009 to 2010.

The £32 million increase in profit before tax attributable to M&G reflects an increase of £46 million in operating profit based on longer-term investment returns, a decrease of £9 million in the actuarial loss on its defined benefit scheme, partially offset by a negative change in the short-term fluctuations in investment returns of £23 million. The increase in operating profit based on longer-term investment returns was primarily driven by favorable equity market levels and exceptionally strong net inflows particularly from the retail business over 2009 and 2010.

The effective tax rate on profits from asset management operations increased from 25 per cent in 2009 to 27 per cent in 2010. The increase in the effective tax rate is a result of less non taxable income in the UK compared to prior years.

The £213 million increase from 2008 to 2009 in profit before tax attributable to shareholders resulted from an increase in profit generated by M&G, which increased from a profit before tax of £81 million in 2008 to a profit before tax of £294 million in 2009. The Group's profit before shareholder tax for the Asian asset management operations increased by £3 million and for the US broker-dealer operations decreased by £3 million from 2008 to 2009.

The £213 million increase in profit before tax attributable to M&G reflected positive movements of £265 million in respect of short-term fluctuations in investment returns, which were partially offset by a decrease in operating profit based on longer-term investment returns of £48 million and a decrease in actuarial gains and losses on its defined benefit scheme of £4 million. The increase in operating profit based on longer-term investment returns reflected the relative levels of equity markets between 2008 and 2009.

The effective tax rate on profits from asset management operations decreased from 32 per cent in 2008 to 25 per cent in 2009. The decrease in effective rate reflects lower taxes in Asia and on certain income in the UK.

**Unallocated corporate result**

Total net of tax charges for unallocated corporate activity increased by £3 million from £432 million in 2009 to £435 million in 2010 and by £187 million from £245 million in 2008 to £432 million in 2009.

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The following table shows the movement in the unallocated corporate result for 2010, 2009 and 2008:

	<b>Year Ended</b>		
	<b>December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Loss before shareholder tax	(920)	(632)	(407)
Shareholder tax	485	200	162
Loss after tax	(435)	(432)	(245)

The 2010 loss before shareholder tax of £920 million includes costs of £377 million incurred in relation to the proposed, and subsequently terminated, transaction to purchase AIA Group Limited. Further details of these costs are presented in Note B1 to the consolidated financial statements in Item 18 of this annual report. The year on year movement in loss before shareholder tax primarily also resulted from an adverse movement in other income and expenditure (including restructuring and Solvency II implementation costs) of £103 million, from £418 million in 2009 to £521 million in 2010, partially offset by a positive change of £178 million in short-term fluctuations in investment returns from a loss of £200 million in 2009 to a loss of £22 million in 2010 and a positive change of £14 million in actuarial gains and losses on Prudential's defined benefit pension scheme.

The increase of £103 million in net other expenditure primarily reflects an increase in interest payable on core structural borrowings and Solvency II implementation costs of £45 million incurred in 2010.

The positive change of £178 million in short-term fluctuations in investment returns was mainly due to a one-off £235 million cost arising from the hedge temporarily put in place during the first quarter of 2009 to protect the Group's IGD capital surplus in the light of exceptional market conditions at that time. During the severe equity market conditions experienced in the first quarter of 2009 coupled with historically high equity volatility, the Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programs. The hedge contracts expired in 2009 and were not renewed.

The effective tax rate on the unallocated corporate result increased from 32 per cent in 2009 to 53 per cent in 2010. This was due to an exceptional tax credit which primarily relates to the impact of the settlement agreed in 2010 with the UK tax authorities and the ability to recognize a deferred tax credit on various tax losses which Prudential was previously unable to recognize, partly offset by the inability to fully recognize a tax credit in respect of non deductible capital costs incurred in relation to the terminated AIA transaction.

The movement in 2009 in loss before shareholder tax primarily resulted from an adverse movement in other income and expenditure of £130 million, from £288 million in 2008 to £418 million in 2009, a negative movement of £82 million in short-term fluctuations in investment returns, from a loss of £118 million in 2008 to a loss of £200 million in 2009, and an adverse change of £13 million in actuarial gains and losses on the Group's defined benefit pension schemes in 2009 in comparison to 2008. The change of £130 million in other income primarily reflects lower returns on central funds as a result of falling interest rates, an increase in interest payable on core structural borrowings and the non-recurrence in 2009 of a positive one-off 2008 item of profit on the sale of a seed capital investment in an Indian mutual fund. The total unallocated corporate result for 2009 included a one-off £235 million cost arising from the hedge as described above.

The movements in 2009 on unallocated actuarial and other gains and losses on the Group's defined benefit pension schemes were primarily due to the provision set up for deficit funding which was partly

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offset by gains in respect of changes of assumptions for scheme liabilities and actual returns on schemes assets being higher than the expected returns.

The effective tax rate on the unallocated corporate result decreased from 40 per cent in 2008 to 32 per cent in 2009. This was due to the ability to recognize in 2009 a deferred tax asset on various tax losses which Prudential was previously unable to recognize offset by adjustments in respect of the prior year tax charge.

**(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 organizational structure, which is by both geography (Asia, US and UK) and by product line (insurance operations and asset management). Prudential's operating segments as determined under IFRS 8, are as follows:

Insurance operations

Asia

US (Jackson)

UK

Asset management operations

M&G

Asian asset management

US broker dealer and asset management (including Curian).

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

The performance measure of operating segments utilized by Prudential is IFRS operating profit based on longer-term investment returns attributable to shareholders. 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 2010 this measure excluded costs associated with the terminated AIA transaction and gain arising upon the dilution of the Group's holding in PruHealth. For 2009 it excluded the non-recurrent cost of hedging Prudential IGD capital surplus included within short-term fluctuations in investment returns and the loss on sale and the results of the Taiwan agency business during the period of ownership. In 2010 the Company amended its presentation of operating profit for its US insurance operations to exclude the net equity hedge accounting effect previously included relating principally to its variable annuity

business as explained

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below. These amounts are included in short-term fluctuations in investment returns. Prior year comparatives have been amended accordingly. There is no change to total profit for continuing operations before tax attributable to shareholders arising from this altered treatment. 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 in note A4 (d) to the consolidated financial statements in item 18.

Segment results that are reported to the GEC include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and Asia Regional Head Office.

For the purposes of measuring operating profit based on longer-term investment returns, investment returns on shareholder-financed business are based on the expected longer-term rates of return. This reflects the particular features of long-term insurance business where assets and liabilities are held for the long term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance for life businesses exclusive of changes in market conditions. In determining profit on this basis, the following key elements are applied to the results of Prudential's shareholder-financed operations.

The approach to determining profit on this basis was altered in 2010 from that previously applied in 2009 and 2008 in respect of the net equity hedge accounting effect for variable and fixed index annuity US life business. Comparative results have been adjusted accordingly. The approach to determining operating profit based on longer-term investment returns reflected in segment results is as follows:

*(i) Debt and equity securities*

Longer-term investment returns comprise income and longer-term capital returns. For debt securities, the longer-term capital returns comprise two elements. These are a risk margin reserve ("RMR") based charge for expected defaults, which is determined by reference to the credit quality of the portfolio, and amortization of interest-related realized gains and losses to operating results based on longer-term investment returns to the date when sold bonds would have otherwise matured. The shareholder-backed operation for which the risk margin reserve charge is most significant is Jackson National Life. For 2010 and 2009 Jackson has used the ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) for residential mortgage-backed securities (RMBS) to determine the average annual RMR. In addition, in 2010, NAIC extended the new ratings framework to commercial mortgage-backed securities (CMBS), which Jackson has used for 2010. These were developed by external third parties, PIMCO (for RMBS) and BlackRock Solutions (for CMBS), and are considered by management more relevant information for the mortgage-backed securities concerned than using ratings by Nationally Recognized Statistical Rating Organizations (NRSRO). For other securities Jackson uses ratings by NRSRO.

*(ii) US variable and fixed index annuity business***Current treatment**

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;

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Movements in accounts carrying value of GMDB and GMWB "for life" liabilities;

Fee assessment, and claim payments, in respect of guarantee liabilities; and

Related changes to amortization of deferred acquisition costs for each of the above items.

**Change of treatment in 2010**

For previous reporting of the 2009 and 2008 results, all of the above items were included in operating profit based on longer-term investment returns with the intention of broadly matching the impacts with two exceptions. The exceptions were for the effect of GMIB reinsurance and movements in carrying values of free standing derivatives and embedded derivatives arising from changes in the level of observed implied equity volatility and changes in the discount rate applied from year to year. Both of these items remain in short-term fluctuations in investment returns in 2010.

Previously, for the purposes of determining operating profit based on longer-term investment returns, the charge for these features was determined using historical longer-term equity volatility levels and long-term average AA corporate bond rate curves with the movement relating to the change in difference in long-term and current rates being included in short-term fluctuations.

However, despite this use of longer-term equity volatility assumption levels and AA corporate bond rate curves, accounting volatility arose within the operating profit based on longer-term investment returns that was not representative of the underlying economic result. This feature arose due to the movement in the change in the accounting values of the derivatives and Jackson's liabilities for variable and fixed indexed annuity guarantees included in the operating profit. Under IFRS, liabilities for GMDB and "for life" GMWB are not fair valued. Instead, they are accounted for under IFRS using "grandfathered" US GAAP in accordance with FASB ASC Subtopic 944-80, Financial Services Insurance Separate Accounts (formerly SOP 03-1). This accounting basis produces a distorting accounting effect on the operating profit that is not representative of the true economics of Jackson's hedging program. Over the long term the impact of this accounting distortion should cumulatively net out to a broadly neutral effect, but in the short term the operating profit can be highly volatile. The recent growth in Jackson's variable annuity business had resulted in this short-term effect having a greater impact on the Group operating profit than in prior years. Further, these accounting mismatches are magnified in periods of significant market movements. These factors have prompted a reassessment of the presentation of operating profit based on longer-term investment returns.

The following items have been reclassified from operating profit to short-term fluctuations in investment returns:

The fair value movement in free standing hedging derivatives, excluding the impact of the difference between longer-term and current period implied equity volatility levels;

The movement in liabilities for those embedded derivative liabilities which are fair valued in accordance with IFRS, primarily GMWB "not for life" and fixed index annuity business, excluding the impacts of the differences between longer-term and current period equity volatility and incorporating 10-year average yield curves, in lieu of current period yield curves;

Movements in IFRS basis guarantee liabilities for GMWB "for life", being those policies where a minimum annual withdrawal is permitted for the duration of the policyholders life subject to certain conditions, and GMDB business for which, under the US GAAP rules applied under IFRS, the reserving methodology under US GAAP principles generally gives rise to a muted impact of current period market movements;

Fee assessment, and claims payments, in respect of guarantee liabilities; and

Related changes to the amortization of deferred acquisition costs for each of the above items.



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The change reflects management's IFRS 8 segment measure. Within the supplementary analysis of profit, the change is presentational only. It has no impact on profit before tax or shareholders' equity. The impact of this change is as follows:

	2010		2009		2008				
	Previous basis £million	Change £million	Revised basis £million	Previous basis £million	Change £million	Revised basis £million	Previous basis £million	Change £million	Revised basis £million
Operating profit based on longer-term investment returns									
Jackson	466	367	833	459	159	618	406	(71)	335
Rest of Group	1,108		1,108	946		946	877		877
Total	1,574	367	1,941	1,405	159	1,564	1,283	(71)	1,212
Short-term fluctuations in investment returns on shareholder-backed business	244	(367)	(123)	36	(159)	(123)	(1,721)	71	(1,650)
Shareholders' share of actuarial and other gains and loss on defined benefit pension schemes	(10)		(10)	(74)		(74)	(13)		(13)
Costs of terminated AIA transaction	(377)		(377)						
Gain on dilution of holding in PruHealth	30		30						
Loss on sale and results of Taiwan agency business				(621)		(621)	1		1
Profit from continuing	1,461		1,461	746		746	(450)		(450)



operations  
before tax  
attributable to  
shareholders

**US operations Embedded derivatives for variable annuity guarantee features**

The Guaranteed Minimum Income Benefit (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 and the asset is therefore recognized 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) Derivative value movements***

Derivative value movements are excluded from operating results based on longer-term investment returns. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging program for features of Jackson's bond portfolio (for which value movements are booked in the statement of comprehensive income rather than the income statement) and product liabilities (for which US GAAP accounting as grandfathered under IFRS 4 does not reflect the economic features being hedged).

Value movements for Jackson's equity-based derivatives and variable and fixed index annuity product embedded derivatives were in prior periods included in operating profits based on longer-term investment returns. In 2010 these value movements, which are variable in nature, have been included in short-term fluctuations and 2009 comparatives have been adjusted accordingly.

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There are two exceptions to the basis described above for determining operating results based on longer-term investment returns. These are for:

Unit-linked and US variable annuity business.

For such business, the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly, all asset value movements are recorded in the operating results based on longer-term investment returns.

Assets covering non-participating business liabilities that are interest rate sensitive.

For UK annuity business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the "operating results based on longer-term investment returns". Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

*(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 investment 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 (i.e. after allocated investment return and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

*a Asia*

*Vietnamese participating business*

For the participating business in Vietnam, the liabilities include policyholders' interest in investment appreciation and other surplus. Bonuses paid in a reporting period and accrued policyholders' interest in investment appreciation and other surpluses primarily reflect the level of realized investment gains above contract-specific hurdle levels. For this business operating profit based on longer-term investment returns includes the aggregate of longer-term returns on the relevant investments, a credit or charge equal to movements on the liability for the policyholders' interest in realized investment gains (net of any recovery of prior deficits on the participating pool), less amortization over five years of current and prior movements on such credits or charges.

The overall purpose of these adjustments is to ensure that investment returns included in operating results equal longer-term returns but that in any one reporting period movements on liabilities to policyholders caused by investment returns are substantially matched in the presentation of the supplementary analysis of profit before tax attributable to policyholders.

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***Non-participating business***

Liabilities are bifurcated so that the total movement in the carrying value of liabilities is split between that which is included in operating results based on longer-term investment returns, and the residual element for the effect of using year-end rates is included in short-term fluctuations and in the income statement.

***Guaranteed Minimum Death Benefit ("GMDB") product features***

For unhedged GMDB liabilities accounted for under IFRS using "grandfathered" US GAAP, such as in the Japanese business, the change in carrying value is determined under FASB Accounting Standards Codification Subtopic 944-80 Financial Services Insurance Separate Account (formerly SOP 03-1), which partially reflects changes in market conditions. Under Prudential's segmental basis of reporting, the operating profit based on longer-term investment returns reflects the change in liability based on longer-term market conditions with the difference between the charge to the operating result and the movement reflected in the total result included in short-term fluctuations in investment returns.

***b UK shareholder-backed annuity business***

With one exception, the operating result based on longer-term investment returns reflects the impact of all value movements on policyholder liabilities for annuity business in PRIL and the PAC non-profit sub-fund.

The exception is for the impact on credit risk provisioning of actual downgrades during the period. As this feature arises due to short-term market conditions the effect of downgrades, if any, in a particular period, on the overall provisions for credit risk is included in the category of short-term fluctuations in investment returns.

The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

***c 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 realized gains and losses (including impairments) in the operating result with unrealized gains and losses being included in short-term fluctuations. For this purpose impairments are calculated as the credit loss determined by comparing the projected cash flows discounted at the original effective interest rate with the carrying value. In some instances it may also be appropriate to amortize realized 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.

Table of Contents**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.

	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
Insurance business			
Long-term business <sup>(ii)</sup>			
Asia	<b>536</b>	416	257
US <sup>(iv)</sup>	<b>833</b>	618	335
UK	<b>673</b>	606	545
Development expenses	<b>(4)</b>	(6)	(26)
Long-term business operating profit	<b>2,038</b>	1,634	1,111
UK general insurance commission	<b>46</b>	51	44
Asset management business			
M&G	<b>284</b>	238	286
Asia asset management	<b>72</b>	55	52
Curian	<b>1</b>	(6)	(3)
US broker-dealer and asset management	<b>21</b>	10	10
	<b>2,462</b>	1,982	1,500
Other income and expenditure	<b>(450)</b>	(395)	(260)
Solvency II implementation costs	<b>(45)</b>		
Restructuring costs	<b>(26)</b>	(23)	(28)
<b>Total IFRS operating profit based on longer-term investment returns<sup>(i)</sup></b>	<b>1,941</b>	1,564	1,212
Short-term fluctuations in investment returns <sup>(v)</sup>			
Insurance operations	<b>(148)</b>	7	(1,337)
IGD hedge costs		(235)	
Other operations	<b>25</b>	105	(313)
Total short-term fluctuations in investment returns	<b>(123)</b>	(123)	(1,650)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	<b>(10)</b>	(74)	(13)
Costs of terminated AIA transaction	<b>(377)</b>		
Gain on dilution of holding in PruHealth	<b>30</b>		
Loss on sale and results of Taiwan agency business <sup>(iii)</sup>		(621)	1
Profit (loss) before tax from continuing operations attributable to shareholders	<b>1,461</b>	746	(450)
Tax (charge) credit attributable to shareholders' returns	<b>(25)</b>	(55)	59
Discontinued operations (net of tax)		(14)	
Profit / (loss) for the year	<b>1,436</b>	677	(391)
Non-controlling interests	<b>(5)</b>	(1)	(5)
<b>Total profit / (loss) for the year attributable to equity holders of Prudential</b>	<b>1,431</b>	676	(396)

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**Notes**

- (i) Operating profit based on longer-term investment returns.

Operating profit based on longer-term investment returns is a supplemental measure of results and is the basis on which management regularly review the performance of Prudential's segments as defined by IFRS 8. For the purposes of measuring

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operating profit, investment returns on shareholder-financed business are based on expected long-term rates of return as discussed above. The expected long-term rates of return are intended to reflect historical rates of return and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The most significant operation that requires adjustment for the difference between actual and long-term investment returns is Jackson. The amounts included in operating results for long-term capital returns for Jackson's debt securities comprise two components. These are a risk margin reserve-based charge for long-term expected defaults, which is determined by reference to the credit quality of the portfolio, and amortization of interest-related realized gains and losses to operating results based on longer-term results to the date when sold bonds would otherwise have matured. Consistent with the policy of including longer-term investment returns in the measure of operating profit, movements in policyholder liabilities are also, where appropriate, delineated between amounts included in operating profit and movements arising from short-term market conditions, which are recorded in short-term fluctuations in investment returns. The presentation of operating profit based on longer-term investment returns has been revised in 2010 and the 2009 and 2008 comparatives have been amended accordingly (see note (iv))

- (ii) Effect of changes to assumptions, estimates and bases of determining life assurance liabilities.

The results of Prudential's long-term business operations are affected by changes to assumptions, estimates and bases of preparation. These are described in notes D2(i), D3(i) and D4(i) contained within the consolidated financial statements in Item 18 of this annual report.

- (iii) Sale of Taiwan agency business.

In order to facilitate comparisons of operating profit based on longer-term investment returns that reflect Prudential's retained operations, the results attributable to the Taiwan business for which the sale process was completed in June 2009 are included separately within the supplementary analysis of profit.

- (iv) Jackson operating results based on longer-term investment returns.

Prudential has amended the presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortization of deferred acquisition costs) and include it in short-term fluctuations. The 2009 and 2008 comparatives have been amended accordingly. The effect of this change is explained above and also in note A4(d)(ii) contained within the consolidated financial statements in Item 18 of this annual report.

- (v) Short-term fluctuations in investment returns on shareholder-backed business comprise:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(£ million)</b>		
<b>Insurance operations</b>			
Asia	<b>114</b>	31	(138)
US	<b>(378)</b>	(132)	(987)
UK	<b>116</b>	108	(212)
<b>Other operations</b>			
IGD hedge costs		(235)	

Other	<b>25</b>	105	(313)
Total	<b>(123)</b>	(123)	(1,650)

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 to the consolidated financial statements in Item 18.

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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 (loss) after tax for 2010, 2009 and 2008.

*Year ended December 31, 2010*

<b>Insurance operations</b>	<b>Asset management</b>	<b>TotalUnallocated segment corpor</b>
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