PRUDENTIAL PLC
Form 20-F
June 22, 2010

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As filed with the Securities and Exchange Commission on June 22, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

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)

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

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

Title of Each Class	Name of Each Exchange on Which Registered
American Depositary Shares, each representing 2 Ordinary Shares, 5 pence par value each	New York Stock Exchange
Ordinary Shares, 5 pence par value each	New York Stock Exchange*
6.75% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Denominated Preference Shares	New York Stock Exchange
6.50% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Denominated Preference Shares	New York Stock Exchange

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

None

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

None

The number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2009 was:

2,532,227,471 Ordinary Shares, 5 pence par value each

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

Yes _X_ No ____

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

Yes ____ No _X_

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

Yes _X_ No ____

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

Large accelerated filer _X_ Accelerated filer ____ Non-accelerated filer ____

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

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

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

Item 17 ____ Item 18 ____

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

Yes ____ No _X_

*

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

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Item 3. Key Information

SELECTED HISTORICAL FINANCIAL INFORMATION OF PRUDENTIAL

The following table sets forth Prudential's selected consolidated financial data for the periods indicated. Certain data is derived from Prudential's audited consolidated financial statements prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"). Were the Group to apply International Financial Reporting Standards as adopted by the European Union ("EU") as opposed to those issued by the International Accounting Standards Board ("IASB"), no additional adjustments would be required. 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 and statement of financial position data for and as at the years ended December 31, 2005 to 2009, as presented in accordance with IFRS, and has been derived from Prudential's consolidated financial statements, audited by KPMG Audit Plc:

	Year Ended December 31,					
	2009(1)	**2009**	**2008**	**2007**	**2006**	**2005**
	(In $ Millions)	**(In £ Millions)**				
Income statement data						
Gross premium earned	**32,817**	**20,299**	18,993	18,359	16,157	15,225
Outward reinsurance premiums	**(522)**	**(323)**	(204)	(171)	(171)	(197)
Earned premiums, net of reinsurance	**32,295**	**19,976**	18,789	18,188	15,986	15,028
Investment return	**43,472**	**26,889**	(30,202)	12,225	17,141	23,120
Other income	**1,995**	**1,234**	1,146	2,457	1,917	1,862
Total revenue, net of reinsurance	**77,762**	**48,099**	(10,267)	32,870	35,044	40,010
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(66,600)**	**(41,195)**	10,824	(26,785)	(28,267)	(33,100)
Acquisition costs and other operating expenditure	**(7,391)**	**(4,572)**	(2,459)	(4,859)	(4,489)	(4,514)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(338)**	**(209)**	(172)	(168)	(177)	(175)
Goodwill impairment charge						(120)
Loss on sale of Taiwan agency business	**(904)**	**(559)**				
Total charges, net of reinsurance	**(75,233)**	**(46,535)**	8,193	(31,812)	(32,933)	(37,909)
Profit (loss) before tax *(being tax attributable to shareholders' and policyholders' returns)*(2)	**2,529**	**1,564**	(2,074)	1,058	2,111	2,101
Tax (charge) credit attributable to policyholders' returns	**(1,323)**	**(818)**	1,624	5	(830)	(1,147)
Profit (loss) before tax attributable to shareholders	**1,206**	**746**	(450)	1,063	1,281	954
Tax (charge) credit attributable to shareholders' profits	**(89)**	**(55)**	59	(354)	(365)	(242)
Profit (loss) from continuing operations after tax	**1,117**	**691**	(391)	709	916	712

Discontinued operations (net of tax)(3)	**(22)**	**(14)**		241	(105)	48
Profit (loss) for the year	**1,095**	**677**	(391)	950	811	760

1

	As of and for the Year Ended December 31,					
	2009(1)	**2009(1)**	**2008**	**2007**	**2006**	**2005**
	(In $ Millions, Except Share Information)	**(In £ Millions, Except Share Information)**				
Statement of financial position data						
Total assets	**368,210**	**227,754**	215,542	219,382	216,528	207,436
Total policyholder liabilities and unallocated surplus of with-profits funds	**317,547**	**196,417**	182,391	190,317	178,539	170,315
Core structural borrowings of shareholder financed operations	**5,487**	**3,394**	2,958	2,492	3,063	3,190
Total equity	**10,190**	**6,303**	5,113	6,164	5,556	5,366
Based on profit (loss) for the year attributable to the equity holders of the Company:						
Basic earnings per share	**43.65¢**	**27.0p**	(16.0)p	38.7p	33.6p	31.6p
Diluted earnings per share	**43.65¢**	**27.0p**	(16.0)p	38.6p	33.6p	31.6p
Dividend per share declared and paid in reporting period(6)	**31.04¢**	**19.2p**	18.29p	17.42p	16.44p	15.95p
Equivalent cents per share(7)		**30.62¢**	35.36¢	34.70¢	30.74¢	29.61¢
Market price at end of period	**1,034.69¢**	**640.0p**	416.5p	712p	699.5p	550p
Weighted average number of shares (in millions)		**2,501**	2,472	2,445	2,413	2,365
Other data						
New business from continuing operations:						
Single premium sales(5)	**23,434**	**14,495**	15,186	14,818	13,928	12,763
New regular premium sales(4)(5)	**2,339**	**1,447**	1,360	1,177	942	708
Gross investment product contributions	**155,295**	**96,057**	63,147	53,759	33,894	26,373
Funds under management	**468,843**	**290,000**	249,000	267,000	251,000	234,000

(1) Amounts stated in US dollars have been translated from pounds sterling at the rate of $1.6167 per £1.00 (the noon buying rate in New York City on December 31, 2009).

(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) Additional information on discontinued operations is set out in note I9 to Prudential's consolidated financial statements in Item 18.

(4) 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.

(5)

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

The table above includes new business for the Taiwan bank distribution operation. New business of the Taiwan agency business, which was sold in June 2009, is excluded from the table. The comparative figures have been restated accordingly.

(6)

Under IFRS, dividends declared after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event. The appropriation reflected in the statement of changes in equity, therefore, includes the final dividend in respect of the prior year. Parent company dividends relating to the reporting period were an interim dividend of 6.29p per share in 2009 (2008: 5.99p, 2007: 5.70p) and a final dividend of 13.56p per share in 2009 (2008: 12.91p, 2007: 12.30p). See "Dividend Data" section below for information regarding the 2009 final dividend.

(7)

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

Dividend Data

Under UK company law, Prudential may pay dividends only if "distributable profits" 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.

On March 1, 2010, Prudential's directors recommended a final dividend for 2009 of 13.56 pence per share payable on May 27, 2010 to shareholders on the register at the close of business on April 9, 2010. On the same date, Prudential announced its agreement with American International Group Inc. ("AIG") for the combination of Prudential and AIA Group Limited ("AIA"), a wholly owned subsidiary of AIG. The cash component of the consideration was envisaged to be part financed by a rights issue which would have required shareholder approval at a General Meeting. In order to minimize the inconvenience to shareholders of having two shareholder's meetings within a short period, Prudential's directors adjourned the AGM on May 19, 2010 and reconvened it on June 7, 2010. One of the consequences of adjourning the AGM was that, in order to pay a dividend of 13.56 pence on May 27, 2010 (as announced on March 1, 2010) that dividend was paid as a second interim dividend. Accordingly, references in this annual report on Form 20-F to the 2009 final dividend should be read as references to the second interim dividend of the same amount. On June 2, 2010, Prudential announced that its agreement with AIG had been terminated.

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 Dividend (pence)	Final Dividend (US Dollars)
2005	5.30	0.0942	11.02	0.2046
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	0.1963

The final dividend for 2009 was 13.56 pence per share. The interim dividend for 2009 was 6.29 pence per share. The total dividend for the year, including the interim dividend and the final dividend, amounts to 19.85 pence per share compared with 18.90 pence per share for 2008, an increase of five per cent. The total cost of dividends in respect of 2009 was £502 million. Dividend cover is calculated as operating profit based on longer-term investment returns after tax on an IFRS basis, divided by the current year total dividend. The full dividend for 2009 is covered 2.2 times by post-tax operating profit based on longer-term investment returns as discussed in Item 5. This compares with dividend cover of 2.2, 1.8, 1.8 and 1.8 for the years 2008, 2007, 2006 and 2005 respectively. The Board will maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account the Group's financial flexibility and the assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

Exchange Rate Information

Prudential publishes its consolidated financial statements in pounds sterling. References in this document to "US dollars", "US$", "$" or "¢" are to US currency, references to "pounds sterling", "£", "pounds", "pence" or "p" are to UK currency (there are 100 pence to each pound) and references to "Euro" or "€" are to the 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.

Year ended December 31,	Average rate
2005	1.82
2006	1.86
2007	2.01
2008	1.84
2009	1.62

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

	High	Low
December 2009	1.66	1.59
January 2010	1.64	1.59
February 2010	1.60	1.52
March 2010	1.53	1.49
April 2010	1.55	1.52
May 2010	1.52	1.43

On June 18, 2010, the noon buying rate was £1.00 = $1.48.

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 which have adversely affected Prudential's business and profitability could be repeated, or prolonged, or could worsen. The adverse effects of such trends, including the unprecedented market dislocation across asset classes and geographical markets witnessed in 2008 and in the first half of 2009, have been and would be felt principally through the following:

- investment impairments or reduced investment returns, as a result of market volatility, could impair 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.

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

A significant part of Prudential's shareholders' profit is related to bonuses for policyholders declared on its with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns. During 2008 and for the first half of 2009, Prudential had to operate in the UK against a challenging background of unprecedented volatility in capital and equity markets, interest rates and widespread economic uncertainty. This has led, among other things, to reduced consumer spending, an increase in unemployment, and consequently reduced liquidity, requiring the intervention of the Bank of England via a quantitative easing program to restore credit liquidity in the market.

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. This residual asset/liability mismatch risk can be managed, but not 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. During 2008, the US financial services industry faced an unprecedented array of challenges: the S&P 500 index fell by 38.5 per cent, government interest rates fell to historic lows, and global markets experienced a significant increase in volatility. In addition, credit markets seized up and global credit spreads widened to historic levels. These factors contributed to substantial increases in Jackson's unrealized losses. Declines in spread from these products or other spread businesses that Jackson conducts could have a material impact on its businesses or results of operations. Jackson also writes a significant amount of variable annuities that offer capital or income protection guarantees. There could be unforeseen market circumstances where the derivatives that it enters into to hedge its market risks may not fully offset its losses, and any cost of the guarantees that remain unhedged will also affect Prudential's results.

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

Prudential will be 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 translation of results into pounds sterling. The currency exposure relating to the translation of reported earnings is not currently separately managed. The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within the statement of changes in equity. Consequently, this could impact on 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). 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 has already initiated the process of developing the detailed rules that will complement the high-level Principles of the Directive, referred to as "implementing measures", which are subject to a consultation process and are not expected to be 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 the 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. The IASB has published proposals in its Phase II discussion paper, which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts according to IFRS and has stated its intention to publish an Exposure Draft in 2010. It is uncertain whether and how the proposals in the discussion paper will become definitive IFRS and when such changes might take effect.

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

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

The resolution of several issues affecting the financial services industry could have a negative impact on 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. This could be a review of business sold in the past under previously acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pension and mortgage endowment policies, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices, including, in the latter case, businesses it has closed.

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

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

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

Litigation, disputes and regulatory investigations may adversely affect 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 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.

As at March 31, 2010:

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

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

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

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

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 2009, 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 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). The Group's ability to exercise management control over its joint venture operations and its investment in them depends on the terms of the joint venture agreements, in particular, the allocation of control among, and continued co-operation between, the joint venture participants. Prudential may also face financial or other exposure in the event that any of its joint venture partners fails to meet its obligations under the joint venture or encounters financial difficulty. In addition, a significant proportion of the Group's product distribution is carried out through arrangements with third parties not controlled by Prudential and is dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements could adversely affect the results of operations of Prudential

Prudential's Articles of Association contain an exclusive jurisdiction provision

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

Changes in tax legislation may result in adverse tax consequences

Tax rules, including those relating to the insurance industry, and their interpretation, may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its 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 includes '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. Forward-looking statements include, without limitation, statements that typically contain words such as 'will', 'may', 'should', 'continue', 'aims', 'believes', 'expects', 'estimates', 'intends', 'anticipates', 'projects', 'plans' or similar expressions. By their nature, forward-looking statements involve material risks and uncertainties because they relate to events and depend on circumstances that all occur in the future. Many of these risks and uncertainties relate to factors that are beyond Prudential's ability to control or estimate precisely, such as future market conditions, fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, the impact of competition, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; and the impact of changes in capital standards, solvency standards or accounting standards, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal actions and disputes, together with other factors discussed in this item under "Risk Factors". This may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. As a result, Prudential's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in the forward-looking statements.

The forward-looking statements contained in this annual report on Form 20-F are made 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. Prudential assumes no obligation or has any intention to publicly update or revise these forward-looking statements, whether as a result of future events, new information or otherwise. 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.

EEV BASIS AND NEW BUSINESS RESULTS

In addition to IFRS basis results, the Group's filings with the UK Listing Authority 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 the Group's life operations. EEV basis results are published semi-annually by the Company in the UK Market.

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. The amounts are not, and are not intended to be, reflective of premium income recorded in the IFRS income statement. From the first quarter of 2010, EEV basis new business profits and margins are also published quarterly.

The Company's KPIs also include IFRS basis operating profit based on longer-term investment returns as explained in Item 5.

Item 4. Information on the Company

BUSINESS OF PRUDENTIAL

Overview

Prudential is a large global financial services group, providing retail financial services in the United Kingdom, the United States and Asia. It has been in existence for over 160 years and has £290 billion in assets under management (as at December 31, 2009). 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, 2009, Prudential Corporation Asia had:

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

In the United States, 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; securities broker-dealers; registered investment advisers; a small captive agency channel, consisting of approximately 100 life insurance agents; and banks, credit unions and other financial institutions.

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

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

- was among the 20 largest life insurance companies in terms of General Account assets(1);
- was ranked 4^{th} in total annuity sales in 2009, up from 11^{th} in 2008(2);

was ranked the top insurance company for overall and sales support satisfaction in the Financial Research Corporation's Adviser Insight Series on market effectiveness[(3)];

was once again rated as a 'World Class' service provider for the fifth successive year by Service Quality Measurement Group[(4)]; and

completed a record sales year with total annual premium equivalent ("APE") retail sales of £912 million, the highest level in Jackson history.

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

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, 2009, Prudential in the United Kingdom:

was one of the market leaders in the individual annuity market and the with-profits market[(5)];

was awarded two Five-Star awards at the Financial Adviser Service Awards in the Life and Pensions and Investments categories;

was named "Best Annuity Provider" at the 2010 Professional Adviser Awards; and

delivered top-quartile investment performance in 38 per cent of M&G's retail funds in the three years to December 2009[(6)].

As at March 31, 2010, the financial strength of The Prudential Assurance Company Limited ("PAC") was rated Aa2 (negative outlook) by Moody's, AA (negative watch) by Standard & Poor's and AA+ (negative watch) by Fitch.

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

(2) Source: Life Insurance and Market Research Association

(3) Source: Adviser Insight Marketing Effectiveness, 2009

(4) Source: Service Quality Measurement Group

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

(6) Source: Morningstar

Group Strategy Overview

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

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

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

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

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

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

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

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

2009 Priorities

A summary of the 2009 priorities and the level of achievement in respect of these for the year is detailed in the table below:

2009 Summary Priorities	2009 Summary Achievements
Group	
Balancing growth with cash and capital conservation	Through prudent and proactive management Prudential enhanced the strength and flexibility of its capital base, increasing its Insurance Groups Directive capital surplus at December 31, 2009 to £3.4 billion
Effectively manage the Group's risk profile	Full year dividend increased by five per cent
Deliver growing dividend, determined after taking into account the Group's financial flexibility and opportunities to invest in areas of business offering attractive returns	Dividend cover of 2.2 times
Targeting 2 times cover over time	
Asia	
Expand the agency force and continue to improve productivity	Record results across a number of metrics in challenging markets
Maximize the potential from non-agency distribution and add new partners	Maintained agency channel momentum
Further develop direct marketing channels and up-sell and cross-sell	Improved proportion of Health and Protection products
Increase focus on retirement services and health products	Successful disposal of capital intensive Taiwan agency back book
	Increased new business profit margins
	Excellent investment performance
Jackson National Life Insurance Company	
Capitalize on market dislocation to advance Jackson market position	Retail sales set a record of £8.9 billion (28 per cent increase year-on-year). Jackson benefited from 'Flight to Quality' as many competitors were downgraded
Write profitable business and conserve IGD capital	Total annuity market share grew from 2.3 per cent in 2001 to 5.9 per cent in 2009, and Jackson climbed from 17th to 4th in the annuity sales rankings
Grow existing retail distribution through organic growth of National Planning Holdings (NPH), Jackson's independent broker-dealer network	Jackson had the largest increase in VA market share in the industry from 2001 to 2009, growing from 1 per cent in 2001 to 8 per cent during 2009
	New business was written at an aggregate after-tax IRR of more than 20 per cent on fully allocated 'AA' capital

2009 Summary Priorities	2009 Summary Achievements
United Kingdom	
Build on strength in the retirement market and risk products	Continued to deploy cash, capital and resources effectively across the UK business
Make the most of Prudential's core capabilities and assets including longevity experience, multi-asset investment expertise, brand, financial strength and large customer base	Focused on core strengths including annuities, pensions and investment products, where its advantage in offering with-profits and other multi-asset investment funds can be maximized
Strengthen distribution capabilities	Launched a new Income Choice Annuity product
Deliver improvement in operational performance and customer service whilst preserving a focus on costs	Prudential's With-Profits Fund has consistently outperformed the market for its long-term investors
Selectively participate in the wholesale market	Gained over 50 new panel positions across 24 key accounts, meaning that Prudential's products are more widely available to intermediaries
	Won two Five-Star awards at the Financial Adviser Service Awards as well as the award for best annuity provider at the Professional Adviser Awards 2010
Asset Management	
Maintain superior investment performance for both internal and external funds	Over the three years to December 2009, 38 per cent of M&G's retail funds delivered top-quartile investment performance
Continue growth in third-party retail and institutional businesses	M&G had a very strong year in 2009 posting record external gross fund inflows of £24.9 billion, an increase of 54 per cent on 2008
	External net inflows of £13.5 billion
	Ranked number 2 based on retail FUM in the UK

2010 Priorities

Group

Prudential's overriding objective for 2010 is to accelerate its proven strategy to capitalize on the most profitable growth opportunities in its chosen markets. On a business unit basis Prudential aims to focus on the following priorities in 2010:

Life insurance

In Asia:

- Expand the agency force and continue to improve productivity

- Maximize the potential from non-agency distribution and add new partners
- Further develop direct marketing channels and up-sell and cross-sell
- Increase focus on retirement services and health products

In the US:

- Continue to innovate around our key variable annuity product
- Continue to focus on improving efficiency of operation

Expand retail distribution

In the UK:

Compete selectively in areas of the retirement income and savings market where Prudential can play to its core strengths and generate attractive returns on capital employed

Maintain a disciplined approach to pricing and capital usage

Continue to build Prudential's distribution capabilities

Deliver further improvements to operational performance and customer service whilst maintaining a strict focus on costs

Maximize the opportunities arising from our significant competitive advantages including Prudential's financial strength, significant longevity experience, multi-asset investment capabilities, strong investment track record, brand and large customer base

Asset management

Maintain superior investment performance for both internal and external funds

Continue growth in third-party retail and institutional businesses

Summary

In 2009, against a backdrop of unprecedented market turbulence, Prudential delivered a strong performance, generating significantly higher profits while consuming less capital.

After the severe difficulties encountered by the world economy and financial markets in the second half of 2008, Prudential entered 2009 with a deliberately defensive position. Recognizing early on the implications of the new economic climate, the Group focused its strategy on capital conservation and cash generation by prioritizing value over volume and allocating capital strictly to the products and channels with the highest rates of return and shortest payback periods. This has led Prudential to significantly reduce its volumes of wholesale business, allowing it to grow its relatively more profitable retail sales.

Asia is the engine of Prudential's future growth, particularly the fast growing economies in South East Asia. In Asia, a challenging economic climate in the first half of 2009 gave way to more positive conditions in the second half of the year. While Prudential saw its single premium volumes decline as a result of economic uncertainty, its regular premium and higher margin protection business remained resilient, ensuring Prudential outperformed the competition, while remaining protected, especially in the second half.

On March 1, 2010, Prudential announced its agreement with AIG for the combination of Prudential and AIA Group Limited, a wholly owned subsidiary of AIG. On June 2, 2010 Prudential announced that this agreement had been terminated. See note I11 to the consolidated financial statements in Item 18 for further details.

Jackson continued to benefit from a flight to quality in the US annuity market. Jackson has continued to implement the strategy of targeting increasing volumes of relatively less capital-intensive variable annuity sales, higher fixed index annuity sales and contained fixed annuity sales.

In the UK, Prudential continues to focus on realizing value from the opportunities created by the increasing need for retirement solutions. The business benefits from a number of competitive advantages including its longevity experience, multi asset investment capabilities, strong brand and financial strength.

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Prudential's asset management business saw strong inflows over the year as its record of generating superior investment performance attracted funds in a turbulent market environment. M&G benefited from its high level of trust and brand loyalty among investors, achieving record net fund inflows, at a time when many other asset managers suffered net redemptions. In Asia, where savers are increasingly becoming investors, Prudential's asset management business put in a resilient performance, while focusing on maintaining profitability across its internal life and third-party clients.

At the start of 2009, Prudential was positioned defensively, but in 2010, Prudential will accelerate and amplify its proven strategy to capitalize on the most profitable growth opportunities in its chosen markets supported by its strong capital position.

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). Prudential's agent in the United States is Jackson National Life Insurance Company, located at 1 Corporate Way, Lansing, Michigan 48951, United States of America.

Significant Subsidiaries

The table below sets forth Prudential's significant subsidiaries.

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

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

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

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

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

Introduction

Prudential's current strategy in Asia is to leverage its platform to generate further shareholder value by continuing to increase the scale of its operations. This is reflected in the following strategic commitments: further increasing agency scale and productivity, continuing to build distribution through partnerships, an increased focus on health and protection and retirement products, further developing direct marketing channels and up-sell and cross-selling capabilities.

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

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

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

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

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

Disposal of PCA Life Taiwan's Agency Business

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

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

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

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

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

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

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

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

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

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

On January 15, 2010 Prudential's Japanese insurance subsidiary announced the cessation of the underwriting of new policyholder contracts post 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.

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

Products

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

Unit-linked products combine savings with protection, with the cash value of the policy depending on the value of the underlying 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.

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

New Business Premiums

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

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

Asset Management

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

In addition, Prudential's Asian asset management business runs a sizeable third-party client business which accounts for 46 per cent of its funds under management as at December 31, 2009. Today it has retail operations in ten markets. During 2009 in China, CITIC-Prudential was awarded the Qualified Domestic Institutional Investors ("QDII") licence, and in Malaysia, Asia Asset Management launched Prudential Al-Wara as its new Islamic fund management subsidiary.

The mutual fund industry continues to diversify its investments, with expectations being for a significant increase in net flows over the coming years. Bank distribution continues to dominate in most markets in Asia, with 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 as of January 2010.

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

Products

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

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

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.

Net Flows and Funds under Management

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

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

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 (National Planning Corporation, SII Investments, Inc., INVEST Financial Corporation and Investment Centers of America, Inc.). At December 31, 2009, Prudential's US operations had more than 2.8 million policies and contracts in effect and PPM America managed approximately £47 billion of assets. In 2009, new business premiums totaled a record £8,909 million.

US Market Overview

The United States is the world's largest retirement savings market, and is continuing to grow rapidly. As 78 million baby boomers[1] reach retirement age, their retirement assets will be expected to shift from asset accumulation to income distribution. There are already US$2 trillion of assets generating retirement income in the US and this amount is forecast to rise to approximately US$7 trillion by 2029[2].

(1) Source: US Census Bureau

(2) Source: Tiburon Strategic Advisers, LLC

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

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

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

Jackson National Life Insurance Company

Jackson is a leading provider of retirement income and savings solutions in the mass and mass-affluent segments of the US market, primarily to those planning for retirement or in retirement already. It offers tools that help people plan for their retirement, and offers products with 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 nine-fold increase in variable annuity sales from 2001 to 2009. Over the same period, Jackson improved its market share from 2.3 per cent in 2001 to 5.9 per cent in 2009 and moved from 17th in total annuity sales to 4th.[3]

(3) Source: Life Insurance and Market Research Association

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

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

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

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

Innovation in product design and speed to market continue to be key drivers of Jackson's competitiveness in the variable annuity market. High-quality and cost-effective technology has allowed Jackson to offer a comprehensive product portfolio that can be customized to meet the needs of individual customers. Jackson offers products on an unbundled basis, enabling customers to select those benefits that meet their unique financial requirements and to pay only for those benefits they desire. In Prudential's view, leveraging this advantage is a more sustainable long-term strategy than competing on price: Jackson will not sacrifice product economics for a short-term increase in market share.

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

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

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

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

Products

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

	Year Ended December 31,		
	2009	**2008**	**2007**
		(£ million)	
By Product			
Annuities			
Fixed annuities			
Interest-sensitive	**915**	1,629	481
Fixed index	**1,433**	501	447
Immediate	**138**	95	91
Variable annuities	**6,389**	3,491	4,554
Total	**8,875**	5,716	5,573
Life insurance	**34**	31	26
Institutional products			
GICs, funding agreements and Federal Home Loan Bank of Indianapolis (FHLBI) advances		560	408
Medium term note funding agreements		634	527
Total		1,194	935
Total	**8,909**	6,941	6,534
By Distribution Channel			
Independent agents	**1,229**	1,225	623
Bank	**1,566**	1,077	812
Broker-dealer	**6,099**	3,428	4,153
Captive agents	**15**	16	10
Institutional products department		1,195	936
Total	**8,909**	6,941	6,534

Annuities

Fixed Annuities

Interest-sensitive Annuities

In 2009, interest-sensitive fixed annuities accounted for 10 per cent of total new business premiums and 24 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 90 per cent of in-force business, Jackson may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, Jackson either pays the contract holder the amount in the contract holder account or begins making payments to the contract holder in the form of an immediate annuity product. This latter product is similar to a UK annuity in payment.

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

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

Jackson's fixed annuities continue to be a profitable book of business, benefiting from 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 61 per cent of the interest-sensitive fixed annuities Jackson wrote in 2009 provide for a market value adjustment that could be positive or negative, on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would 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 16 per cent of total new business premiums in 2009 and 10 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.

Immediate Annuities

In 2009, immediate annuities accounted for two 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 2009, variable annuities accounted for 72 per cent of total new business premiums and 49 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 seven years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Jackson offers one variable annuity that has no surrender charges.

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

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

In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to 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, the equity exposure remains well managed. As evidence of Jackson's hedging program, over the cumulative 24-month period of 2008 and 2009, which included a historic decline and partial recovery of equity markets as well as significant interest rate movements, Jackson's variable annuity guaranteed benefits and related hedges resulted in a net operating loss of £7 million, after allowing for variable annuity guarantee fees in the period.

Life Insurance

Reflecting the competitive life insurance market and the overall trend towards asset accumulation products, Jackson's life insurance products accounted for less than one per cent of the total new business premiums and nine per cent of policyholder liabilities of the US operations in 2009. Jackson sells several types of life insurance, including term life, universal life and variable universal life. Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a life insurance policy that combines death benefit protection and the important tax advantages of life insurance with the long-term growth potential of professionally managed investments. Jackson's life insurance book has also delivered consistent profitability, driven primarily by positive mortality and persistency experience.

Institutional Products

Institutional products consist of guaranteed investment contracts ("GICs"), funding agreements, including agreements issued in connection with participation in the Federal Home Loan Bank of Indianapolis ("FHLBI") program, and medium term note funding agreements. During 2009, there was no new institutional business as the company restricted sales in this business line in order to conserve and direct capital to higher margin variable annuity business. As at December 31, 2009, institutional products accounted for six per cent of policyholder liabilities of US operations. The GICs are marketed by the institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its program. Three types of institutional products are offered:

- Traditional GICs;
- Funding agreements; and
- Medium term note funding agreements.

Traditional Guaranteed Investment Contracts

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

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

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

Funding Agreements

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

Typically, brokerage accounts and money market mutual funds are required to invest a portion of their funds in cash or cash equivalents to ensure sufficient liquidity to meet their customers' requirements. The funding agreements permit termination by the policyholder on seven to 90 days' notice, and thus qualify as cash equivalents for the clients' purposes. There were no funding agreements terminable by the policyholder with less than 90 days' notice outstanding at December 31, 2009.

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 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 21,000 appointed insurance agents or brokers (as at December 31, 2009), who also may represent other companies, are supported by four regional marketing divisions. JNLD generally deals directly with writing agents and brokers thereby eliminating intermediaries, such as general agents. This distribution channel has enabled Jackson to generate significant volumes of business on a low, variable cost basis. Jackson also provides agents with product information and sales materials.

JNLD's wholesalers meet directly with broker-dealers and financial planners and are supported by an extensive internal sales staff. As at December 31, 2009, there were more than 780 active selling agreements with regional and independent broker-dealer organizations throughout the United States, which provides Jackson access to nearly 65,000 appointed agents.

Jackson provides training for its broker-dealers and also provides them with product information and sales materials.

Banks, Credit Unions and Other Financial Institutions

Jackson's Institutional Marketing Group distributes annuity and life insurance products through banks, credit unions and other financial institutions and through third-party marketing organizations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and as at December 31, 2009 had access to more than 12,500 financial institution representatives through existing relationships with banks and credit unions. Jackson has established distribution relationships with medium-sized regional banks, which it believes are unlikely to develop their own insurance product capability.

Independent Broker-Dealers

Jackson's retail distribution is managed by 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 3,478 registered representatives at the end of 2009.

Registered Investment Adviser

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

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

Institutional Products Department

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

Captive Agency

In connection with the acquisition of Life of Georgia in 2005, Jackson established the JNL Southeast Agency ("JNLSA"), the company's first captive agency since 1970. JNLSA, with more than 100 life insurance agents as at December 31, 2009, was formed to help retain the Life of Georgia book of business and to create a new distribution channel for Jackson's life insurance.

Factors Affecting Pricing of Products and Asset Liability Management

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

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

Jackson segregates its investment portfolio for certain investment management purposes and as part of its overall investment strategy into four portfolios: fixed annuities without market value adjustment, fixed annuities with market value adjustment, fixed index annuities and institutional liabilities. The portfolios backing fixed annuities with and without market value adjustments and the fixed index annuities have similar characteristics and differ primarily in duration. The portfolio backing the institutional liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the institutional portfolio is managed to permit less interest rate sensitivity and has limited exposure to mortgage-backed securities. As at December 31, 2009, 10 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 at December 31, 2009, 62 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 conjunction with the sales of variable annuity contracts expose Jackson to equity risk as the benefits generally become payable when equity markets decline below the guaranteed amount. Certain of these benefits are carried at fair value under IAS 39 with changes in fair value recorded in income. Jackson hedges the tail risk associated with the equity exposure using equity options and futures contracts, which are also carried at fair value under IAS 39. Jackson hedges the economic risk associated with these contracts and, therefore, has not explicitly hedged its fair value risk. In addition, certain benefits have mortality risk and are therefore precluded from being carried at fair value. As a result of these factors, the income statement may include a timing mismatch related to changes in fair value. However, as demonstrated during 2008 and 2009, Jackson's hedges operated effectively, as designed.

Reserves

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

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 eight 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 business ceded to any one reinsurer is not material. Typically, the reinsurers have an AM Best Co rating of A or higher.

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

Beginning in late 1995, Jackson entered into reinsurance agreements to cede 80 per cent of its new level premium term life insurance business written in the United States to take advantage of competitive pricing in the reinsurance markets. Beginning on January 1, 1999, it began to cede 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 cedes the guaranteed minimum income benefit on variable annuities to an unaffiliated reinsurer.

Policy administration

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

PPM America

PPM America is Prudential's US fund management operation, with offices in Chicago and New York. Its primary focus is to manage funds for Jackson and therefore the majority of funds under management are fixed interest in nature. PPM America also serves as investment adviser for certain mutual funds, several private investment funds and structured finance vehicles, and the US equity and fixed income portion of portfolios of certain affiliates within Prudential.

UK Business

Introduction

As at December 31, 2009, Prudential's UK business was structured into two business units, each focusing on its respective target customer markets. Prudential's UK business units are UK Insurance Operations and M&G.

The following discussion describes:

- the UK retail financial services market;
- Prudential's UK business units, products and distribution channels;
- Prudential's reinsurance arrangements and reserving practice; and
- shareholders' participation in Prudential's long-term insurance business.

In 2009, Prudential's UK business generated new business insurance premiums of £5,014 million and gross investment inflows of £24,875 million. As at December 31, 2009, M&G had £174 billion of funds under management.

UK Retail Financial Services Business Overview

Prudential UK (the UK insurance operations) continues to focus on realizing value from the opportunities created by the increasing need for retirement solutions. Prudential's UK business competes in selected areas of the UK's retirement savings and income markets where it believes that it can generate attractive returns from capital employed. In line with Prudential's strategy, the business continues to place significant emphasis on the disciplined deployment of capital to seize opportunities that play to the core strengths of the business and this focus enabled it to deliver a strong relative performance in 2009.

In 2009, Prudential UK performed strongly against a challenging background of difficult capital markets, volatile equity markets and widespread economic uncertainty which led consumers to look for greater certainty and security through trusted and financially strong brands. Prudential UK believes that the business has a strong combination of competitive advantages including its longevity experience, multi-asset investment capabilities, strong brand and financial strength. These help put Prudential UK in a robust position to generate attractive returns across its businesses.

The UK is characterized by an ageing population and the concentration of wealth in the mass affluent and high net worth sectors a combination that positions the retirement and near-retirement segment as the fastest-growing in the marketplace. Low savings rates and high levels of consumer debt, coupled with an increasing shift in responsibility for providing retirement income away from the Government and employers towards individuals, have resulted in individuals in the UK being inadequately provided for during increasingly long periods of retirement.

Areas of focus in 2009

- Maintaining a leadership position in individual annuities;
- Building on Prudential's multi-asset capabilities and expertise;
- Growing other income streams;
- Strengthening distribution capabilities;
- Delivering improvements in customer service; and
- Maintaining a disciplined approach to pricing and capital usage.

The pipeline of internal vestings from maturing individual and corporate pension policies is expected to remain strong at least over the next ten years. Management have based this assessment on a combination of analysis of the projected value of maturities of in-force business (after allowing for lapses) used within Prudential's actuarial valuation models as at December 31, 2008 and analysis of the Selected Retirement Date contained with the policy data for a population covering approximately 75 per cent of in-force pension business. This pipeline is supplemented by strategic partnerships with third parties where Prudential UK is the recommended annuity provider for customers vesting their pensions at retirement. Prudential UK is one of the largest annuity providers in the UK market[1], with approximately 1.5 million annuities in payment as at December 31, 2009. Looking ahead, the UK annuities market is expected to grow in the near-term, and Prudential UK believes it is well-positioned to maintain a significant share of this market.

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(1) Source: ABI

Prudential UK's with-profits business performed strongly during 2009, showing that with-profits, when invested in an actively managed and financially strong fund like Prudential's, continues to be an attractive medium to long-term investment, offering strong annualized returns compared with other investment options. Prudential UK's with-profits fund has delivered investment returns of 66.3 per cent

over the last ten years through the end of 2009 compared with the FTSE All-Share Index (total return) of 17.7 per cent over the same period.

In the wholesale markets, Prudential UK's aim is to participate selectively in bulk and back-book buyouts using Prudential's financial strength, superior investment track record and annuitant mortality risk assessment capabilities. Maintaining a strict focus on value means that Prudential UK will only participate in transactions that meet its strict return on capital requirements.

The business has also continued to make good progress against its cost reduction plans, with Prudential UK expecting that it will have achieved its total cost savings target of £195 million per annum by the end of 2010. The first phase of the Prudential UK cost reduction program (completed in 2007) delivered savings of £115 million per annum, with a further £60 million per annum of savings expected to be delivered by the end of 2010 through the administration outsourcing agreement with Capita, which commenced in April 2008. The remaining £20 million per annum is expected to be generated from across the rest of the UK business by the end of 2010. By the end of 2009, a total of £156 million per annum of savings had been delivered.

Over time, the Capita contract is expected to result in the migration of approximately seven million in-force policies from a number of Prudential legacy IT systems to two Capita proprietary platforms, significantly enhancing operational performance and efficiencies. The first migration from a legacy system to a Capita platform was completed during 2009.

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'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.

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

The defined charge participating sub-fund ("DCPSF") forms part of PAC's long-term fund and comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into PAC from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and the with-profits annuity business transferred to PAC from the Equitable Life Assurance Society on 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 was a long-term savings product with a life insurance component. The life insurance element conferred tax advantages that distinguished the traditional life insurance products offered in the United Kingdom from the savings products offered by banks, building societies and unit trust companies. The gradual reduction of these tax advantages and increasing sales of single premium life products have resulted in the distinction between life insurance and other long-term savings products becoming less important. Pension products remain tax-advantaged within certain limits.

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

Distribution

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

Direct and e-commerce distribution methods are generally lower-cost than other methods but have not generally been conducive to providing financial advice to the consumer to date. Accordingly, products distributed directly are generally more straightforward and have lower, often fee-based, charges.

The FSA, following a consultation process, implemented "depolarization" rules at the end of 2004. Advisers have the choice of being "single tied" as before, or "multi-tied"; advising on the products of a limited range of providers, or equivalent to an independent financial adviser ("IFA"), where they offer products from the "whole of market" as now, but they also have to offer a "fee alternative", a fee-based charging structure as an alternative to commission. Prudential UK worked with major financial adviser groups to design and build multi-tie propositions and has been appointed to a number of multi-tie panels of these major financial adviser groups.

The FSA is conducting a review of the retail distribution marketplace called the Retail Distribution Review ("RDR") and published a policy statement on March 26, 2010, which follows nearly two years of discussion and consultation papers. The changes are designed to encourage greater levels of transparency, professionalism and sustainability within the industry, with the prime aim of increasing consumers' confidence in the industry and therefore their desire to engage with it. Prudential supports the concepts of adviser remuneration and the new professional standards which are included as part of the RDR and believes that these provide an opportunity to put in place a framework that will better align the interests of consumers, advisers and providers. The proposed implementation date for the proposals remains December 31, 2012.

The changes to be implemented are centered on improving the clarity with which firms describe their services to customers and the role of advisers, particularly with regards to remuneration. The advice market will be split between independent and restricted advice. This will be supported by the need for specific disclosure of status both in writing and orally at point of sale. Commission will be replaced by "Adviser Charging" with prescriptive rules aimed at ensuring consumers have total clarity on the cost of advice services. This will apply to all investment advice, but advisers will continue to be able to be remunerated by commission for pure protection business. In a separate discussion paper, the FSA proposed a number of changes to the Platform market which made clear that the same standards will apply as to the Retail market.

The Professionalism and Qualification elements are expected to be agreed in 2010. A greater role is proposed for professional bodies in helping to set and manage the ethics agenda in the industry. The FSA is proposing to revert to an internal model for the Professional Standards Board rather than establishing this as a separate independent entity.

The proposals on independent advice (which is restricted and unbiased) and raising professional standards will help to achieve improved outcomes for consumers.

The full impact of the RDR cannot yet be predicted, but it is likely that cash flow will be an issue for IFA firms that are currently reliant on initial commission. Although some IFAs may choose to exit the market, Prudential believes that many will adapt to the new environment. Prudential UK has been preparing for the introduction of RDR for some time for instance, Prudential UK's current individual pensions product, the Flexible Retirement Plan is now priced excluding commission, which allows the margin deducted for advice to be specifically agreed between the customer and the adviser. A large proportion of Prudential UK's annuity sales are made on a non-advised basis and will be unaffected by these changes.

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

As at December 31, 2009, Prudential's UK Insurance Operations distributes its products through the following channels:

	Year Ended December 31,		
	2009	**2008**	**2007**
	(£ million)		
Direct & Partnerships	**2,015**	2,567	2,597
Intermediated	**2,810**	3,029	2,319
Wholesale (including Credit Life)	**62**	1,434	1,820
Sub-Total	**4,887**	7,030	6,736
DWP Rebates	**127**	153	143
Total New Business Premiums	**5,014**	7,183	6,879

Direct and Partnerships

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

Intermediaries

Prudential UK's intermediaries distribution channel increased its field sales force with an additional 13 regional sales units in 2009, and the focus is to continue developing deeper and better relationships with key accounts and through partnership arrangements. Prudential UK was successful in gaining over 50 new panel positions across its 24 key accounts in 2009, meaning that its products are now even more widely available to intermediaries than before.

Wholesale

Prudential UK maintained its strict focus on value in the bulk annuity and back-book markets in 2009, completing transactions generating premium income of £39 million compared with £1,417 million in 2008. The 2008 figure included the large bulk annuity transactions which have not been repeated in 2009, due to the unavailability of transactions which met Prudential's return criteria.

UK Business Units

Long-term Products

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

	Year Ended December 31,		
	2009	**2008**	**2007**
		(£ million)	
Life insurance			
With-profits	**1,320**	968	406
Unit-linked	**610**	939	899
Total life insurance	**1,930**	1,907	1,305
Pensions			
With-profits individual	**154**	77	29
Unit-linked individual	**86**	89	80
Department of Work and Pensions rebates	**127**	153	143
Corporate	**386**	651	680
Total pensions	**753**	970	932
Pension annuities and other retirement products			
Fixed	**1,445**	2,427	1,742
Retail Price Index	**493**	1,404	659
With-profits	**382**	459	2,228
Total pension annuities and other retirement products	**2,320**	4,290	4,629
Healthcare	**11**	16	13
Total new business premiums	**5,014**	7,183	6,879

Life Insurance Products

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

Savings Products Investment Bonds

Prudential offers customers a choice through a range of investment funds to meet different risk and reward objectives. Prudential launched the Flexible Investment Plan ("FIP") in 2003 and the Prudential Investment Plan ("PIP") in 2007. Through these plans, its customers have the option to invest in the With-Profits fund or in a range of unit-linked investment funds. Advisers can build an individual portfolio and asset allocation model to accurately match a client's risk/reward profile. Both FIP and PIP also give financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In 2009, sales of the unit-linked option of FIP and PIP were £117 million.

The Prudence Bond, a single premium, unitized with-profits policy with no fixed term, is one of the United Kingdom's leading investment bond products in terms of with-profits market share. In September 2004, Prudential launched the next generation with-profits investment bond, entitled PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer. PruFund also offers clients an optional five-year guarantee on the initial investment. In 2008, PruFund became available as a fund option on the FIP and PIP products. In 2009, total new business premiums attributable to PruFund, including new business through FIP and PIP, was £1,082 million.

In March 2008, Prudential launched the International Portfolio Account ("IPA") offering clients access to a wide range of quoted UK investments. Sales of Prudential's offshore bonds, the International Prudence Bond, International Prudential Portfolio Bond and International Portfolio Account were £315 million in 2009.

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

Sales of PruFund, Prudential UK's unitized and smoothed investment plan, were particularly strong in 2009. Since October 2008, PruFund has been available across Prudential UK's range of tax wrappers, including individual pensions, income drawdown and onshore and offshore bonds. Over £1.3 billion was invested across the Prudential UK retail savings product range in 2009. In 2009, Prudential UK extended further the PruFund range of investments with the launch of the PruFund Cautious series to sit alongside the PruFund Growth series within the on-shore bond wrapper. As at December 31, 2009, approximately £300 million had been invested in PruFund Cautious since it was launched in the second half of 2008. Prudential also launched the new PruSelect range of unit-linked funds across its UK pensions and investments products in 2008, more than doubling the number of funds available.

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

Since its launch in October 2004, PruHealth has established itself in the marketplace as a private medical insurance provider, and it now has more than 200,000 customers insured.

PruProtect, launched in September 2007, follows the success of PruHealth by applying the Vitality points system. PruProtect's product is focused around a core philosophy of helping people become healthier while protecting and improving the quality of their lives. PruProtect continues to grow sales strongly following the re-launch of its product range and improved distribution model in November 2008. Sales of £14 million were achieved in 2009, an increase of 311 per cent over 2008.

Pension Products

Prudential UK provides both individual and corporate pension products. In 2009 new business premiums totaled £240 million for individual pensions and £386 million for corporate pensions. Pension products are tax-advantaged long-term savings products that comply with rules established by HMRC and are designed to supplement state-provided pensions. These rules require that, upon retirement, maturity benefits are used to purchase pension annuities by policyholder election at retirement or at least by the age of 75, although they do permit a portion to be taken as a tax-free lump sum. Prior to retirement, these products typically have minimal mortality risk to Prudential and are primarily considered investment products. An exception is where a guaranteed annuity option has been offered on the product, with an element of risk to Prudential both in underlying mortality and investment assumptions.

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 one per cent of the with-profits sub-fund as at December 31, 2009.

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

Individual Pensions

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

In 2001, Prudential UK introduced products that continue to 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 one per cent thereafter, which is below the charges on personal pension products previously offered by the UK pensions industry.

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

Prudential UK also provides individual personal pension products through the DWP Rebate arrangement. Under this arrangement, individuals may elect to contract out of the UK's State Second Pension (referred to as "S2P") which was previously known as State Earnings Related Pension Scheme, administered by the UK Department of Work and Pensions. If an individual elects to contract out, then he or she will designate a pension provider, such as Prudential. Premiums on products sold in this manner are paid through "rebates" from the Department of Work and Pensions, which represent the amount that would be otherwise paid into S2P. Rebate amounts are invested to provide benefits to the individual. Premiums from Department of Work and Pensions Rebates are typically reported in the first quarter of each year.

Corporate Pensions

There are two categories of corporate pension products: defined benefit and defined contribution. Prudential has an established defined benefit plan client base covering the small to medium-sized employer market. Prudential UK's defined contribution client base ranges from small unlisted companies to some of the largest companies in the United Kingdom as well as a number of clients in the public sector (in particular where Prudential UK offers the Additional Voluntary Contribution facility). Additional Voluntary Contribution plans enable employees to make additional pension contributions, either regularly or as a lump sum, to supplement their occupational pension plans.

Defined benefit plans and products continue to dominate the corporate pensions market in terms of funds under management. In recent years, however, most new plans established have been defined contribution products. In addition, there is an increasing trend among companies to close defined benefit plans to new members or to convert existing schemes from defined benefit to defined contribution in order to 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 2009, Prudential UK sold £91 million of income drawdown products. A total of £2,189 million of individual annuities were sold in 2009. Of this total, £1,357 million were sold to existing Prudential UK customers with maturing pension policies. The other £832 million were sold to new customers, typically individuals with a pension maturing with another provider who chose Prudential UK to provide their annuity. Prudential UK also offers bulk annuities, whereby it manages the assets and accepts the liabilities of a company pension scheme, usually when it is being wound up by the employer. Due to the nature of the product, the volume of Prudential UK's bulk annuity sales is unpredictable as it depends on the decision of scheme trustees. In 2009, Prudential UK sold £39 million of bulk annuities.

Prudential UK's immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products. The primary risks to Prudential UK from immediate annuity products, therefore, are mortality improvements and credit risk.

Conventional Annuities

Prudential UK's conventional annuities include level (non-increasing), fixed increase and RPI annuities. Prudential UK's fixed increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The RPI annuities provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK Retail Prices Index. In 2009, sales of RPI annuities were £493 million (including £19 million of bulk annuities). In 2009, sales of level and fixed increase annuities amounted to £1,445 million (including £20 million of bulk annuities and £43 million of unit-linked income drawdown products).

With-profits Annuities

Prudential UK's with-profits annuities combine the income features of annuity products with the investment smoothing features of with-profits products and enable policyholders to obtain equity-type returns over time. Through this product, Prudential UK brings its product development strengths to bear while also capitalizing on people's need for protection from inflation through increasingly long periods of retirement. Prudential is one of only a few companies in the United Kingdom in the with-profits annuities market and has been operating in this market since 1991. In 2009, Prudential UK's premiums for this business were £382 million (including £48 million of with-profits income drawdown products). Prudential UK is now the market leader, with a market share of over 84 per cent in the nine months to September 2009[1].

(1) Source: ABI

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

Income drawdown

Given the UK's compulsory annuitization age of 75, an increasingly sophisticated consumer population, and the rising incidence of second careers and semi-retirement as a result of increasing longevity, the market has seen good growth in the 'bridge' between pensions and annuities through income drawdown products. Prudential UK launched an income drawdown option as a part of the Flexible Retirement Plan in late 2007 and achieved premiums of £91 million in 2009 compared to £75 million in the previous year for this and the existing product, the Flexible Income Retirement Account. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth.

Lifetime mortgage

In November 2009, Prudential UK announced the decision to close its equity release operation to new business. For this product, a significant cash expense is incurred up front in acquiring new business and the payback period on capital employed is long. Prudential UK management concluded that this is not sustainable and that cash and capital can be deployed more effectively across other parts of the business. Prudential UK's existing lifetime mortgage customers are unaffected by this decision.

Reinsurance

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

Reserves

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

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

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

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

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

Financial Strength of PAC's Long-term Fund

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

PAC's with-profits fund is one of the largest and financially strongest in the UK, continuing to cover comfortably all of its regulatory solvency requirements. The fund is supported by an inherited estate of £6.4 billion (as at December 31, 2009) which provides the working capital required to support the fund for the long-term benefit of current and future policyholders.

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

	2009	2008
	(%)	
UK equities	**25**	34
International equities	**12**	17
Property	**12**	14
Fixed Interest	**40**	29
Cash and other asset classes	**11**	6
Total	**100**	100

Despite difficult conditions in financial markets throughout 2008 and during the first half of 2009, the with-profits sub-fund performed strongly in 2009. With-profits, when invested in an actively managed and financially strong fund like PAC's, continues to be an attractive medium to long-term investment, offering annualized returns which compare favorably with other investment options. The with-profits sub-fund has delivered investment returns of 66.3 per cent over ten years compared with the FTSE All-share index (total return) of 17.7 per cent over the same period (figures are to December 31, 2009, before tax and charges). Much of this strong investment performance was achieved through the active asset allocation of the fund. As part of its asset allocation process, Prudential UK constantly evaluates prospects for different markets and asset classes. During the year, PAC's long-term fund reduced its exposure to equities and increased its exposure to fixed interest securities.

Realistic Financial Strength Reporting

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

This basis makes companies' financial health more transparent to policyholders, intermediaries and regulators alike, and enables more informed choices to be made by policyholders. The PAC long-term with-profits sub-fund is very strong with the inherited estate (free assets) measured on a realistic basis, valued at approximately £6.4 billion at the end of 2009 before deduction for the risk capital margin.

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

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

With-profits Products

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

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

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

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

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

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

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

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

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

In 2009, PAC declared a total surplus of £2,149 million from PAC's primary with-profits sub-fund, of which £1,935 million was added to with-profits policies and £214 million was distributed to shareholders. This includes annual bonus rates of three per cent per annum for the Prudence Bond and three per cent per annum for personal pensions. In 2008, PAC declared a total surplus of £3,029 million from PAC's primary with-profits sub-fund, of which £2,730 million was added to with-profits policies and £298 million was distributed to shareholders. This includes annual bonus rates of 3.5 per cent for the Prudence Bond and 3.5 per cent for personal pensions.

The closed Scottish Amicable Insurance Fund ("SAIF") declared total bonuses in 2009 of £533 million compared to £777 million in 2008. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business. For greater detail on the SAIF fund, see "The SAIF sub-fund and accounts" below.

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

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

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

Prudential UK, of which PAC is part, announced in March 2006 that it had begun a process to determine whether it could achieve greater clarity as to the status of the inherited estate through reattribution. In June 2008, Prudential announced that it did not believe that it was in the interests of current or future policyholders or shareholders to continue the reattribution process. This announcement reflects PAC's overriding priority, which is to maintain the long-term financial security of the with-profits sub-fund and to continue delivering strong relative performance for the benefit of its policyholders.

Depletion of Surplus Assets and Shareholders' Contingencies

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

In 1998, Prudential UK stated that deducting personal pensions mis-selling costs from the inherited estate of the with-profits sub-fund would not impact Prudential UK's bonus or investment policy. Prudential UK gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged.

The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing. The mis-selling review was completed on June 30, 2002 and consequently 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 SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency. Due to the quality and diversity of the assets in SAIF and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the Directors believe that the probability of either the PAC's long-term fund or Prudential UK's shareholders' funds having to contribute to SAIF is remote.

Non-participating Business

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

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

Guaranteed Annuities

PAC used to sell guaranteed annuity products in the United Kingdom and held a provision of £31 million as at December 31, 2009, 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 £284 million was held in SAIF as at December 31, 2009, to honor the guarantees. As SAIF is a separate sub-fund of PAC's long-term business fund, this provision has no impact on shareholders.

M&G

M&G is Prudential's fund management business in the United Kingdom and continental Europe and comprises retail, institutional and internal fund management activities. Its key metrics of performance are investment performance, net investment flows and profits.

Fund management

M&G is an investment-led business which aims to deliver superior investment performance and maximize risk-adjusted returns in a variety of macro-economic environments. Through M&G, Prudential seeks to add value by generating attractive returns on internal funds as well as growing profits from the management of third party assets. Such external funds now represent 40 per cent of M&G's total FUM as at December 31, 2009.

In the retail market, M&G's strategy is to maximize the value of its centralized investment function through a multi-channel, multi-geography distribution approach. Key themes in recent years have included the growing proportion of business sourced from intermediated channels and the growth of cross-border products. M&G has benefited from having a diverse product portfolio during the recent financial turmoil as inflows were received throughout 2009 despite investors' appetite for bond funds switching to equity funds during the second half of the year.

M&G's institutional strategy centers on leveraging capabilities developed primarily for internal funds into higher margin external business opportunities. In recent years this has allowed M&G to operate at the forefront of a number of specialist fixed income strategies, including leveraged finance and infrastructure investment. The recent chaos in capital markets has resulted in a renewed focus on more traditional credit and equity mandates, again drawing on its core research and investment expertise.

Key initiatives and performance

Delivering fund performance remains critical and is the key determinant of success for an active asset management business. M&G has continued to deliver market-leading investment performance in 2009 with strong results.

In the three years to December 2009, 38 per cent of M&G's retail funds delivered top-quartile investment performance[1]. Over the same period, 89 per cent of M&G's active institutional funds delivered returns ahead of their benchmarks. On the back of this strong investment performance M&G delivered record net third party fund inflows of £13.5 billion in 2009, an increase of 296 per cent year on year.

(1) Source: Morningstar

Gross third party fund inflows rose 54 per cent to £24.9 billion. These third party inflows and the recovery of equity markets in the latter half of 2009 led to a 23 per cent increase in M&G's total funds under management to £174 billion. As at December 31, 2009, 40 per cent of M&G's funds under management were for third party clients.

M&G's retail business had a strong year in 2009, seeing net inflows jump by 259 per cent over the year to £7.5 billion. Gross fund sales were up 50 per cent at £13.6 billion. Sales of M&G's top-performing fixed income funds accounted for most of the inflows for most of the year before investor appetite switched to M&G's equity and property funds during the second half of 2009 as sentiment turned more bullish.

Similarly, the Institutional Business attracted a high level of net new third party business. Net inflows were £6.0 billion, a rise of 354 per cent on 2008. This included the award of a single fixed income mandate valued at £4 billion and £0.8 billion of net new money into M&G's leveraged loan funds. Gross fund sales were up 59 per cent at £11.3 billion.

Net sales remained robust in the fourth quarter of 2009. The retail business attracted net new money of £1.8 billion, more than double the £0.7 billion taken in the same quarter in 2008. Gross retail sales were £3.8 billion. The institutional business took £0.6 billion of net new business over the final three months compared with an outflow of £1.4 billion for the same period a year ago. Gross sales were 93 per cent higher year-on-year at £2.7 billion.

During 2009, M&G's cost/income ratio was 65 per cent, increasing from 60 per cent in 2008. The increase can largely be attributed to the reinstatement of costs associated with the long-term incentive plan ("LTIP") as the medium-term outlook for the business improved in light of strong fund inflows and recovering market levels. M&G remains focused on cost control.

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

	December 31,	
	2009	**2008**
	(£ billion)	
Retail fund management	**31**	19
Institutional fund management	**39**	28
Internal fund management	**104**	94
Total	**174**	141

Prudential Capital

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

The business has consolidated its position in a period of difficult and volatile markets, focusing on liquidity across Prudential, 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. Prudential Capital is committed to working closely with other business units across Prudential to exploit opportunities and increase value creation for Prudential as a whole. In particular, Prudential Capital offers to Prudential a holistic view on hedging strategy, liquidity and capital management.

Group Risk Framework

Risk Management

Introduction

As a provider of financial services, including insurance, Prudential recognizes that the managed acceptance of risk lies at the heart of its 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 tolerance to 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 (a) the volatility of earnings is consistent with stakeholders' expectations, (b) Prudential has adequate earnings (and cash flows) to service debt, for expected dividends and to withstand unexpected shocks, and (c) earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies. The two measures applied to monitor the volatility of earnings are EEV operating profit and IFRS operating profit, although EEV and IFRS total profits are also considered.

(b) Capital requirements: the limits aim to ensure that (a) Prudential meets its internal economic capital requirements, (b) Prudential achieves its desired target rating to meet its business objectives, and (c) supervisory intervention is avoided. The two measures applied are the EU Insurance Groups Directive ("IGD") capital requirements and internal economic capital requirements. In addition, capital requirements are also monitored on a local statutory basis.

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

Local limits are agreed with each of the business units to ensure that the aggregate risk exposure remains within the defined group-level risk appetite. Each business unit determines its own individual risk position by calculating the impacts (on earnings and capital measures) of a shock to its market, credit, insurance and operational risk exposures and agrees them with Group Risk and the Group Executive Risk Committee ("GERC").

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

In the event that any of the business unit plans imply risk limits will be exceeded, this will necessitate a dialogue between GERC and the relevant business unit or units. Exceeding group limits may be avoided if, for example, limits in other business units are not fully 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 total group-wide exposures to a single counterparty are specified within different credit rating "categories". Group Risk and the GERC monitor Prudential's actual exposures against these limits on a monthly basis.

Risk exposures

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

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

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 £6.4 billion as at December 31, 2009 (2008: £5.4 billion), which can absorb market fluctuations and protect the fund's solvency. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy. In the course of 2009, Prudential has reduced the with-profits fund's exposure to UK equities whilst increasing the proportion of fixed income assets.

In Asia, a high proportion of 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 guarantees for minimum death benefits ("GMDB") on all policies in this class, minimum withdrawal benefits ("GMWB") on 47 per cent of the book, and minimum income benefits ("GMIB") on only eight per cent. To protect the shareholders against the volatility induced by these embedded options, both a comprehensive hedging program and reinsurance are used. Due to the inability to reinsure economically or hedge the GMIB, Jackson ceased offering this benefit in 2009.

Jackson's variable annuity sales activities focus on meeting the needs of conservative and risk averse customers who are seeking accumulation pre-retirement and/or reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers select conservative investment options and, importantly, have historically bought fewer guarantee products compared to the industry as a whole. Jackson is able to meet the needs of these customers because its unique and market leading operational platform allows it to tailor more than 1,400 product combinations.

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

Prudential uses a macro approach to hedging that covers the entire equity risk in the US business. Within this macro approach use is made of the natural offsets that exist between the variable annuity guarantees and the fixed index annuity book, and then a combination of over the counter options and futures is used to hedge the residual risk, allowing for significant market shocks and limiting the amount of capital put at risk. 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. Accordingly, while its hedges are effective on an economic basis, due to different accounting treatment for the hedges and some of the underlying hedged items, the reported income effect is more volatile. For Jackson's variable annuities guaranteed benefits and related hedges, while there has been some volatility of results in 2008 and 2009, there has been a small cumulative net operating loss of £7 million over the 24-month period, reflecting the overall effectiveness of the hedging program. With its large fixed annuity and fixed indexed annuity books, Jackson has natural offsets for its variable annuity interest rate related risks. Specific limits are set for each major risk.

(ii) Interest rate risk

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

Interest rates primarily affect the Asia, the US and the UK with-profits businesses. Following the sale of the agency-based business in Taiwan, the exposure to interest rate risk in Asia has significantly reduced. The remaining risk in the region relates mostly to guarantees on traditional shareholder-backed life products and asset-liability mismatches, driven by limited availability of long-term assets in some territories. This exposure is monitored and managed carefully on an ongoing basis, for example by setting clear limits on duration risk set in the investment guidelines. Prudential has a range of risk mitigation options available that would help to reduce the exposure to interest rate movements.

In the US, there is interest rate risk across the portfolio. Jackson manages fixed annuity interest rate exposure through a combination of interest rate swaps and interest rate options, to protect capital against rates rising quickly, and through the contractual ability to reset crediting rates annually.

In the UK, the investment policy for the shareholder-backed annuity business is to match the cash flow from investments with the annuity payments. As a result, assets and liabilities are closely matched by duration. The impact of any residual cash flow mismatching can be adversely affected by changes in interest rates, therefore the mismatching position is regularly monitored.

(iii) Foreign exchange risk

Prudential principally operates in the UK, the US, and in 13 countries in Asia. The geographical diversity of the businesses means that it is inevitably subject to the risk of exchange rate fluctuations. The results of Prudential's international operations in the US and Asia represent a significant proportion of the Group's operating profit and shareholders' funds. These operations generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in the consolidated financial statements when results are expressed in pounds sterling.

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

(b) Credit risk

Debt portfolio

1. Information regarding the 2009 results

Prudential's debt portfolio on an IFRS basis was £101.8 billion as at December 31, 2009. £45.6 billion of these assets backed shareholder business, of which 93 per cent were investment grade, compared to 96 per cent at December 31, 2008. This change was a result of downgrades, largely occurring in March and April, with the pace of downgrade significantly slowing subsequently. Sovereign debt backing shareholder business represented 11 per cent of the portfolio, or £4.9 billion as at December 31, 2009; 67 per cent of this was AAA and 91 per cent investment grade. Eurozone sovereign exposures backing shareholder business were £3.1 billion as at December 31, 2009; 98 per cent of these were AAA rated. Of the remaining two per cent, the highest exposure was in respect of Italy (£55 million) and Spain (£1 million) whilst there was no exposure to Greece, Portugal or Ireland.

Asia's debt portfolio totaled £10.0 billion as at December 31, 2009. Of this, approximately 75 per cent was invested in unit-linked and with-profits funds with minimal shareholders' risk. The remaining 25 per cent was shareholder exposure and was invested predominantly (79 per cent) in investment grade bonds. For Asia, the portfolio performed very well, and did not experience any default losses in 2009.

The UK's debt portfolio on an IFRS basis was £67.8 billion as at December 31, 2009, including £42.3 billion within the UK with-profits fund. Shareholders' risk exposure to the with-profits fund is limited as the solvency is protected by the large inherited estate. Outside the with-profits fund there was £6.4 billion in unit linked funds where the shareholders' risk is limited, with the remaining £19.0 billion backing the shareholders' annuity business and other non-linked business (of which 78 per cent is rated AAA to A, 19 per cent BBB and three per cent non-investment grade).

On a statutory (Pillar 1) basis, Prudential held prudent credit reserves within the UK shareholder annuity funds of £1.6 billion as at December 31, 2009 to allow for future credit risk. For Prudential Retirement Income Limited ("PRIL") this allowance was set at 71 bps as at December 31, 2009 (2008: 80 bps). This represented 41 per cent of the portfolio spread over swaps compared to 31 per cent as at June 30, 2009 and 25 per cent as at December 31, 2008. A low level of new defaults (£11 million) were reported on the debt portfolio held by the UK shareholder-backed annuity business in 2009.

During the second half of 2009, Prudential materially reduced its holdings in subordinated financial debt backing the annuity business, which improved the overall credit quality of its bond portfolios. This resulted in gross losses of £254 million on shareholder-backed business and £80 million on policyholder backed business. On a Pillar I basis these losses were fully offset by a reduction in long-term default reserves of £180 million shareholder/£31 million policyholder that arose as a result of the improvement in the quality of its remaining bond portfolios and a further £74 million shareholder/£49 million policyholder release of short-term default reserves which were allocated to the assets sold. On an IFRS basis, the gross costs less the reduction in long-term and short-term default reserves resulted in an overall pre-tax operating loss of £51 million shareholder/£32 million policyholder in 2009.

The most significant area of exposure to credit risk for the shareholders is Jackson in the US. As at December 31, 2009 Jackson's fixed income portfolio totaled £22.8 billion, comprised of £16.5 billion of Corporate Debt, £2.1 billion of Commercial Mortgage Backed Securities ("CMBS"), £3.3 billion of Residential Mortgage Backed Securities ("RMBS") and £0.9 billion of other instruments.

The US Corporate Debt portfolio of £16.5 billion was 94 per cent investment grade as at December 31, 2009. Concentration risk was low, with the top ten holdings accounting for less than seven per cent of the portfolio. The non-investment grade portfolio was also well diversified with an average holding of £8 million. The largest sector exposures in the investment grade portfolio were Utilities and Energy both at 15 per cent. The portfolio is actively managed and exposures are sold as events dictate.

Within the RMBS portfolio of £3.3 billion, the agency guaranteed portion was 60 per cent as at December 31, 2009. Another 21 per cent of the portfolio was non-agency prime and Alt-A investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. Prudential's exposure to the 2006/2007 vintages totaled £466 million as at December 31, 2009 of which £373 million was invested in the senior part of the capital structure, thereby significantly reducing the risk of defaults and the magnitude of loss if a shortfall were to occur. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS was £93 million. The total RMBS portfolio had an average fair value price of 78 cents in the dollar.

The CMBS £2.1 billion portfolio is performing strongly, with 46 per cent of the portfolio rated AAA and less than one per cent rated below investment grade as at December 31, 2009. The entire portfolio had 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 was £631 million as at December 31, 2009 (2008: £624 million). This was net of recoveries/reversals recognized in the year of £5 million (2008: £3 million).

In 2009, Jackson's total defaults were less than £1 million (2008: £78 million). In addition, as part of its active management of the book, it incurred net losses of £6 million (2008: £130 million) on the sale of impaired bonds.

IFRS write downs excluding defaults for 2009 were £630 million compared to £419 million in 2008. Of this amount £509 million (2008: £167 million) was in respect of RMBS securities.

The impairment process reflects a rigorous review of every single bond and security in its portfolio. The accounting requires Prudential to book full mark to market losses on impaired securities through the income statement. However, it would expect only a proportion of these losses eventually to turn into defaults, and some of the impaired securities to recover in price over time.

In considering potential future losses for Jackson, it is essential to examine the key components of the debt portfolio. As at December 31, 2009, 93 per cent of Jackson's total debt portfolio of £22.8 billion consisted of investment grade securities and seven per cent were non-investment grade.

The debt portfolio of Prudential's asset management operations of £1.2 billion as at December 31, 2009 principally comprises £1.1 billion related to Prudential Capital operations. Of this amount, debt securities of £1.1 billion were rated AAA to A- by S&P or Aaa by Moody's.

2. Information regarding the position at March 31, 2010

On May 17, 2010, Prudential published its first quarter 2010 Interim Management Statement with the UK Listing Authority. This statement included details on credit risk as at March 31, 2010 as follows:

The Group's total debt portfolio on an IFRS basis is estimated at £102.8 billion at March 31, 2010 excluding holdings attributable to external unit holders of consolidated unit trusts. Of this total, £68.9 billion is in the UK, including £44.5 billion within the UK with-profits fund. Shareholders have limited risk exposure to the with-profits fund as the solvency is protected by the inherited estate. Outside the with-profits fund there is £4.5 billion in unit-linked funds where the shareholder risk is limited, with the remaining £19.9 billion backing the shareholder annuity business and other non-linked business (of which 78.4 per cent is rated AAA to A, 18.8 per cent BBB and 2.8 per cent non-investment grade). No defaults were reported in the first quarter of 2010 for UK shareholder backed business.

Asia's debt portfolio totals £7.2 billion of which £3.5 billion is invested in unit-linked and with-profits funds with minimal shareholder risk and £3.7 billion held by shareholder backed non-linked business. No defaults were reported in the first quarter of 2010.

Therefore, 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, 2010 is estimated £25.4 billion. As reported at December 31, 2009 the net unrealized position continues to benefit from the market recovery from the historically wide spreads at the end of 2008. Jackson's net unrealized gains has increased to £0.4 billion at March 31, 2010 from £4 million at the end of December 31, 2009.

Loans

Of the total Group loans of £8.8 billion as at December 31, 2009, £6.9 billion were held by shareholder-backed operations comprising of £4.5 billion commercial mortgage loans and £2.4 billion of other loans.

Of this total held by shareholder-backed operations, the Asian insurance operations held £0.4 billion of other loans, the majority of which are commercial loans held by the Malaysian operation that are investment graded by two local rating agencies. The US insurance operations held £4.3 billion of loans, comprising £3.8 billion of commercial mortgage loans, all of which are 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 £0.8 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. The bridging loan assets generally have no external credit ratings available, with internal ratings prepared by Prudential's asset management operations as part of the risk management process, with the majority being rated BBB+ to BBB-.

Unrealized Credit Losses in the US

1. Information regarding the 2009 results

Jackson's net unrealized position moved from a loss of £2,897 million as at December 31, 2008 to a net gain of £4 million as at December 31, 2009 as the markets rebounded from the historically wide spreads at the end of 2008. The gross unrealized loss position moved from £3,178 million as at December 31, 2008 to £966 million as at December 31, 2009. Gross unrealized losses on securities priced at less than 80 per cent of face value totaled £594 million as at December 31, 2009 compared to £1.9 billion as at December 31, 2008.

2. Information regarding the position at March 31, 2010

Prudential's first quarter 2010 Interim Management Statement as mentioned above also included updates on the Jackson's unrealized losses position as at March 31, 2010 as follows. Further information on Jackson's unrealized losses position at March 31, 2010 is also provided in Item 5 in the section headed *"IFRS Critical Accounting Policies"*.

Gross unrealized losses on securities priced below 80 per cent of book value were £0.5 billion at March 31, 2010 compared to £0.6 billion at the end of December 31, 2009.

Jackson did not experience any losses on defaults during the first quarter of 2010. Write downs of impaired securities in the first quarter of the year were £35 million, of which £26 million were on Residential Mortgage Backed Securities (RMBS). No write downs were reported on corporate bonds. This compares to total write downs of £152 million for the first quarter 2009. In addition losses of £76 million were incurred in the first quarter of 2010 on sales of impaired and deteriorating bonds (first quarter 2009: £15 million). The increase over first quarter 2009 was the result of Jackson utilizing opportunities to continue de-risk the portfolio.

(c) Insurance risk

The processes of determining the price of products and reporting the results of long-term business operations require Prudential to make a number of assumptions. In common with other industry players, the profitability of Prudential's businesses depends on a mix of factors including mortality and morbidity trends, persistency, investment performance, unit cost of administration and new business acquisition expenses. Almost all of Prudential's longevity risk arises in the UK, where this is managed as a key risk and where Prudential conducts rigorous research using data from its substantial annuitant portfolio. In other parts of the world, longevity risk is a very minor part of the risk profile. Prudential's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Where appropriate, allowance is also made for the relationship either assumed or historically observed between persistency and investment returns and for the resulting additional risk.

(d) Liquidity risk

The holding company has significant internal sources of liquidity which are sufficient to meet all of its expected requirements for the foreseeable future without having to make use of external funding. In aggregate Prudential had £2.1 billion of undrawn committed facilities as at March 31, 2010, of which, in February 2009, it renewed £1.4 billion of the undrawn syndicated committed banking facility for a further three years. Prudential also has two £100 million undrawn bilateral committed banking facilities expiring in 2011 and 2012, with the balance being an annually renewable £500 million committed securities lending facility. In addition Prudential has access to liquidity via the debt capital markets, which was demonstrated most recently through the two hybrid instruments, £400 million of Lower Tier 2 debt issued in May 2009 and US$750 million (approximately £455 million) of Innovative Tier 1 debt issued in July 2009, and a £250 million senior three-year MTN issued in January 2010. Liquidity is also assessed at business unit level under base case and stressed assumptions. The liquidity resources available have been assessed to be sufficient under both sets of assumptions.

Non-financial Risk

Prudential is exposed to operational, business environment and strategic risk in the course of running its businesses. It processes a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory, including tax, regimes. It also has a significant number of third-party relationships that are important to the distribution and processing of its products, both as market counterparties and as business partners.

Prudential uses the qualitative and quantitative analysis of operational risk exposures material to Prudential to support business decisions, to inform overall levels of capital held and to assess the adequacy of the corporate insurance program.

Capital Management

Regulatory capital (IGD)

Prudential is subject to the capital adequacy requirements of the EU Insurance Groups Directive (IGD) as implemented by the FSA in the UK. The IGD capital adequacy requirements involve aggregating surplus capital held in Prudential's regulated subsidiaries, from which group borrowings, except those subordinated debt issues that qualify as capital, are deducted. No credit for the benefit of diversification is permitted under this approach.

Prudential's position has been further strengthened during 2009, driven by its prudent but proactive risk management. Its IGD capital surplus was £3.4 billion as at December 31, 2009 (before allowing for the 2009 final dividend) giving solvency ratio of 283 per cent. This compared to a surplus as at December 31, 2008 (before allowing for the 2008 final dividend) of £1.5 billion[(1)] and a solvency ratio of 152 per cent. The positive movement of £1.9 billion during 2009 mainly comprised:

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(1) Source: Audited annual regulatory return under Insurance Groups Directive (Form 95)

- Net capital generation mainly through operating earnings (in-force releases less investment in new business) of £1.1 billion;

- The impact of the sale of the agency distribution business in Taiwan of £0.8 billion;

- Hybrid debt issues in May and July 2009, totaling £0.9 billion;

- Additional recognition of £0.4 billion of surplus in respect of part of the shareholders' interest in the future transfers from the PAC with-profit fund, recognition of £0.2 billion of future profits in the UK and Hong Kong and other intra-group capital efficiencies of £0.3 billion;

Offset by:

- Final 2008 dividends, net of scrip, of £0.2 billion and interim 2009 dividends, net of scrip, of £0.1 billion;

- External financing costs and other central costs of £0.6 billion;

Credit-related impairments and default losses in the US of £0.4 billion;

Impacts arising from regulatory changes of £0.2 billion;

Foreign exchange movements of £0.3 billion.

Prudential has strengthened its IGD capital position in challenging markets. It continues to have further options available to it to manage available and required capital. These could take the form of either increasing available capital (for example, through financial reinsurance or debt issuance) or reducing required capital (for example, through the level and the mix of new business, notably by maintaining pricing discipline and through the use of other risk mitigation strategies such as hedging and reinsurance).

In addition to this strong capital position, the total credit reserve for the UK shareholder annuity funds, which protects Prudential's capital position in excess of the IGD surplus, has been strengthened to £1.6 billion as at December 31, 2009 (from £1.5 billion at September 30, 2009). This reserve is equivalent to 71 bps per annum over the lifetime of the assets.

During the severe equity market conditions experienced in the first quarter of 2009 Prudential entered into exceptional overlay short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programs. The hedge contracts have expired and not been renewed.

Stress testing

As at December 31, 2009, the impact of an instantaneous 20 per cent fall in equity markets levels (which is equivalent to the worst historic daily fall in the S&P index), would reduce IGD surplus by £150 million. Were equity markets to fall by more than 20 per cent, Prudential believes that this would not be an instantaneous fall but rather this would be expected to occur over a period during which it would be able to put into place mitigating management actions. For example, Prudential has estimated that the impact (net of mitigating management actions) of an additional 20 per cent fall in equity markets over a four-week period following an instantaneous 20 per cent fall would be an estimated reduction in the IGD surplus of a further £350 million.

In summary, the findings of Prudential's stress testing and sensitivity analysis, which are part of the continual process of assessing the resilience of Prudential's IGD capital position to withstand significant further deterioration in market conditions include:

- An instantaneous 20 per cent fall in equity markets from December 31, 2009 levels would reduce IGD surplus by £150 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 £500 million.
- A 150 bps reduction (subject to a floor of zero) in interest rates from December 31, 2009 would reduce the IGD surplus by £400 million.
- Credit defaults of 10 times the expected level would have an impact of £550 million in excess of the annual reserve release.

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

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

Information regarding the capital position at March 31, 2010

On May 17, 2010, Prudential published its first quarter 2010 Interim Management Statement with the UK listing Authority. This statement included details on the capital position as at March 31, 2010 as follows:

Prudential's capital position remains strong. Prudential has continued to place emphasis on maintaining the Group's financial strength through optimizing the balance between writing profitable new business, conserving capital and generating cash. The Group's IGD capital surplus was estimated at £3.4 billion at March 31, 2010 (before taking into account the 2009 final dividend of £0.3 billion), covering its capital requirements 2.7 times. This compared to £3.4 billion at the end of 2009 and £2.3 billion at the end of the first quarter of 2009 (before taking into account the 2008 final dividend of £0.3 billion).

The IGD capital surplus at March 31, 2010 was unchanged since the end of 2009. This primarily reflected a positive contribution from the underlying earnings, offset by inadmissible assets arising on the purchase of UOB's life insurance subsidiary in Singapore of £0.2 million and the impact of costs incurred to the end of March 2010 in relation to the proposed AIA acquisition and its financing. On June 2, 2010, Prudential announced that its agreement with AIG for the combination of Prudential and AIA had been terminated. See note I11 to the consolidated financial statements in Item 18 for further details.

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

- An instantaneous 20 per cent fall in equity markets from March 31, 2010 levels would reduce the IGD surplus by £250 million;

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

- A 150bps reduction (subject to a floor of zero) in interest rates would reduce IGD surplus by £350 million;

- Credit defaults of ten times the expected level would reduce IGD surplus by £600 million.

In addition to the Group's strong capital position, on a statutory (Pillar 1) basis the credit reserve for the UK shareholder annuity funds also protects the Group's capital position in excess of the IGD surplus. This credit reserve as at March 31, 2010 was £1.6 billion. This represented 44 per cent of the portfolio spread over SWAPs, compared to 41 per cent at December 31, 2010, and 31 per cent as at June 30, 2009.

Solvency II

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

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

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

The European Commission has already initiated the process of developing the detailed rules that complement the high-level principles in the Directive, referred to as "implementing measures". These are subject to a consultation process that is not expected to be finalized until late 2011.

In particular, the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") published a number of consultation papers in 2009 covering advice to the European Commission on the implementing measures but there remains significant uncertainty regarding the outcome from this process. Prudential is actively participating in shaping the outcome through its involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Fora, together with the Association of British Insurers ("ABI") and the Comité Européen des Assurances ("CEA").

Many of the issues being actively debated have received considerable focus both within the industry and from national bodies.

Having assessed the high-level requirements of Solvency II, an implementation program was initiated with dedicated teams to manage the required work across Prudential. The activity of the local Solvency II teams is being coordinated by Group Head Office to achieve consistency in the understanding and application of the requirements.

Prudential is progressing its implementation plans further and remaining in regular contact with the FSA as it prepares for the initial stage of the approval process for the internal model.

Capital allocation

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

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.

Capital performance metrics are based on economic capital, which provides a view of the Prudential's capital requirements across the group, allowing for realistic diversification benefits. Economic capital also provides valuable insights into the Prudential's 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, it maintains risk registers that include details of the risks it has identified and of the controls and mitigating actions it employs in managing them. Any mitigation strategies involving large transactions such as a material derivative transaction are subject to review at group level before implementation.

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 Prudential's business and functions establish processes for identifying, evaluating and managing the key risks faced by Prudential. The framework is based on the concept of "three lines of defence": risk management, risk oversight and independent assurance.

Risk management: The primary responsibility for strategy, performance management and risk control lies with the Board, the Group Chief Executive and the chief executives of each business unit.

Risk oversight: Risk exposures are monitored and reviewed by group-level risk committees, chaired by the Group Chief Risk Officer or the Chief Financial Officer:

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

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

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

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

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

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

- 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 Prudential'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 Prudential 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, i.e.:

- The retention of the risk contributes to value creation;

- Prudential is able to withstand the impact of an adverse outcome; and

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

Prudential has the following five objectives for risk and capital management:

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

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

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

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

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

Reporting

The Group Executive Committee and the Board are provided with regular updates on Prudential's economic capital position, overall position against risk limits and RAP. They also receive the annual financial condition reports prepared by Prudential's insurance operations.

The Group Audit Committee is provided with minutes of the Group Operational Risk Committee, and regular updates on financial and operational risk exposures.

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

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

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

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 at December 31, 2009. In addition, at December 31, 2009 Prudential had £80.9 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, 2009								
	UK Insurance	US Insurance	Asia Insurance	Total Insurance	Asset Mgmt(a)	Other	Total	Less: assets to cover linked liabilities and external unit holders(b)	Group excluding assets to cover linked liabilities and external unit holders
				(£ million)					
Investment properties	**10,861**	**33**	**11**	**10,905**			**10,905**	**(884)**	**10,021**
Investments accounted for using the equity method	**4**		**2**	**6**			**6**		**6**
Financial investments:									
Loans	**1,815**	**4,319**	**1,207**	**7,341**	**1,413**		**8,754**	**(27)**	**8,727**
Equity securities	**37,051**	**20,984**	**11,182**	**69,217**	**137**		**69,354**	**(35,517)**	**33,837**
Debt securities	**67,772**	**22,831**	**9,984**	**100,587**	**1,164**		**101,751**	**(13,364)**	**88,387**
Other investments	**3,630**	**955**	**258**	**4,843**	**113**	**176**	**5,132**	**(116)**	**5,016**
Deposits	**11,557**	**454**	**746**	**12,757**	**63**		**12,820**	**(929)**	**11,891**
Total financial investments	**121,825**	**49,543**	**23,377**	**194,745**	**2,890**	**176**	**197,811**	**(49,953)**	**147,858**
Total investments	**132,690**	**49,576**	**23,390**	**205,656**	**2,890**	**176**	**208,722**	**(50,837)**	**157,885**

(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 balance sheet. 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 balance sheet.

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.

Prudential's Investment Yields

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

	Year Ended December 31,					
	2009		2008		2007	
	Yield	Amount (£ million)	Yield	Amount (£ million)	Yield	Amount (£ million)
Investment properties						
Net investment income	**6.6%**	**700**	5.6%	676	4.9%	611
Net realized investment (losses) gains	**(0.6)%**	**(63)**	(0.4)%	(51)	1.2%	147
Net unrealized investment (losses) gains	**(0.7)%**	**(76)**	(28.2)%	(3,372)	(5.8)%	(723)
Ending assets		**10,021**		11,282		12,658
Investments accounted for using the equity method						
Net investment income	**0%**	**0**	0%	0	0%	0
Net realized investment gains	**0%**	**0**	0%	0	0%	0
Net unrealized investment gains	**0%**	**0**	0%	0	0%	0
Ending assets		**6**		10		12
Loans						
Net investment income	**4.8%**	**461**	6.0%	549	6.4%	425
Net realized investment (losses) gains	**(1.1)%**	**(105)**	2.3%	210	0.7%	47
Net unrealized investment gains	**0%**	**0**	0%	0	0%	0
Ending assets		**8,727**		10,378		7,887
Equity securities						
Net investment income	**3.9%**	**1,373**	3.8%	1,731	4.5%	2,388
Net realized investment gains	**5.5%**	**1,905**	4.5%	2,014	8.7%	4,633
Net unrealized investment gains (losses)	**14.8%**	**5,165**	(39.7)%	(17,897)	(3.0)%	(1,589)
Ending assets		**33,837**		35,821		54,452
Debt securities						
Net investment income	**6.9%**	**5,939**	1.3%	1,071	5.9%	4,335
Net realized investment losses	**(0.7)%**	**(572)**	(0.7)%	(573)	(0)%	(18)
Net unrealized investment gains (losses)	**3.9%**	**3,380**	(2.9)%	(2,348)	(1.5)%	(1,129)
Ending assets		**88,387**		84,929		75,114
Other investments						
Net investment income	**0.6%**	**32**	3.0%	155	2.5%	119

Net realized investment (losses) gains	**(9.7)%**	**(541)**	(33.6)%	(1,745)	6.4%	306
Net unrealized investment (losses) gains	**(0.4)%**	**(23)**	(34.8)%	(1,805)	14.4%	687
Ending assets		**5,016**		6,097		4,275
Deposits						
Net investment income	**0.7%**	**64**	8.4%	534	5.5%	365
Net realized investment gains	**0%**	**0**	0%	0	0%	0
Net unrealized investment gains	**0%**	**0**	0%	0	0%	0
Ending assets		**11,891**		6,391		6,353
Total						
Net investment income	**5.5%**	**8,569**	3.0%	4,716	5.2%	8,243
Net realized investment gains (losses)	**0.4%**	**624**	(0.1)%	(145)	3.3%	5,115
Net unrealized investment gains (losses)	**5.4%**	**8,446**	(16.1)%	(25,422)	(1.8)%	(2,754)
Ending assets		**157,885**		154,908		160,751

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 86 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 14 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.

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

For Prudential's UK 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.

Investments

The following table summarizes the total investments of the UK insurance business at December 31, 2009.

	At December 31, 2009					
	SAIF	PAC	Other	Total	Less: assets to cover linked liabilities and external unit holders(a)	Total excluding assets to cover linked liabilities and external unit holders
				(£ million)		
Investment properties	**710**	**8,049**	**2,102**	**10,861**	**(884)**	**9,977**
Investment accounted for using the equity method			**4**	**4**		**4**
Financial investments:						
Loans	**138**	**968**	**709**	**1,815**		**1,815**
Equity securities	**2,994**	**23,277**	**10,780**	**37,051**	**(11,248)**	**25,803**
Debt securities	**4,797**	**37,542**	**25,433**	**67,772**	**(6,861)**	**60,911**
Other investments	**340**	**3,035**	**255**	**3,630**	**(72)**	**3,558**
Deposits	**869**	**8,755**	**1,933**	**11,557**	**(550)**	**11,007**
Total financial investments	**9,138**	**73,577**	**39,110**	**121,825**	**(18,731)**	**103,094**
Total investments	**9,848**	**81,626**	**41,216**	**132,690**	**(19,615)**	**113,075**

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

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, 2009. 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, 2009					
	With-Profits	PRIL	SAIF	Other	Total	Total %
			(£ million)			
Investment properties	7,975	968	710	324	9,977	8.8
Investments accounted for using the equity method				4	4	
Financial investments:						
Loans:						
Mortgage loans	145	37		666	848	
Policy loans	15		9		24	
Other loans	808	6	129		943	
Total loans and receivables	968	43	138	666	1,815	1.6
Equity securities:						
United Kingdom:						
Listed	14,121	3	1,805	77	16,006	
Unlisted	323		45		368	
Total United Kingdom	14,444	3	1,850	77	16,374	14.5
International:						
United States	1,482		195		1,677	
Europe (excluding the United Kingdom)	2,807		392		3,199	
Japan	680		99		779	
Pacific (excluding Japan)	1,741		253	5	1,999	
Other	1,569		206		1,775	
Total international	8,279		1,145	5	9,429	8.3
Total equity securities	22,723	3	2,995	82	25,803	22.8
Debt securities:						
UK government	2,364	1,424	205	415	4,408	
US government	529		1	4	534	
Other	34,174	15,210	4,591	1,994	55,969	
Total debt securities	37,067	16,634	4,797	2,413	60,911	53.9
Other investments:						
Participation in investment pools	1,590		223		1,813	
Other financial investments	850				850	
Derivative assets	590	174	117	14	895	
Total other investments	3,030	174	340	14	3,558	3.2

Deposits	**8,755**	**586**	**868**	**798**	**11,007**	**9.7**
Total investments	**80,518**	**18,408**	**9,848**	**4,301**	**113,075**	**100.0**

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 £25,803 million invested in equities at December 31, 2009. Most of these equities support Prudential Assurance's with-profits fund and the SAIF fund, both of which are managed using the same general investment strategy.

The following table shows the geographic spread of this equity portfolio by market value in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At December 31, 2009 Market Value (£ million)	(%)
United Kingdom	**16,374**	**63.5**
United States	**1,677**	**6.5**
Europe (excluding United Kingdom)	**3,199**	**12.4**
Japan	**779**	**3.0**
Pacific (excluding Japan)	**1,999**	**7.7**
Other	**1,775**	**6.9**
Total	**25,803**	**100.0**

The UK equity holdings are well diversified and broadly mirror the FTSE All-Share share index. Prudential held equities in 463 UK companies at December 31, 2009. The ten largest holdings in UK equities at December 31, 2009 amounted to £6,731 million, accounting for 41.1 per cent of the total UK equity holdings of £16,374 million supporting the UK insurance operations. The following table shows the market value of the ten largest holdings in UK equities at December 31, 2009.

	At December 31, 2009 Market Value (£ million)	(%)
BP	**1,109**	**6.8**
HSBC Holdings	**1,007**	**6.1**
Vodafone Group	**807**	**4.9**
GlaxoSmithKline	**749**	**4.6**
Royal Dutch Shell	**681**	**4.2**
British American Tobacco	**544**	**3.3**
Rio Tinto	**705**	**4.3**
Tesco	**376**	**2.3**
Astrazeneca	**396**	**2.4**
BHP Billiton	**357**	**2.2**
Total	**6,731**	**41.1**

A wide variety of industry sectors are represented in Prudential's equity portfolio. At December 31, 2009, within the £16,374 million in UK equities supporting the UK insurance operations, Prudential had £10,341 million, or 63.2 per cent of the holdings, invested in ten industries. The following table shows the primary industry concentrations based on market value of the portfolio of UK equities relating to the UK insurance business at December 31, 2009.

	At December 31, 2009	
	Market Value (£ million)	(%)
Oil and Gas Producers	2,324	14.2
Mining	1,546	9.4
Banks	1,527	9.3
Pharmaceuticals and Biotech	1,225	7.5
Tobacco	853	5.2
Mobile Telecommunications	808	4.9
Travel & Leisure	628	3.8
Aerospace and defense	507	3.2
Gas, Water & Multi Utilities	482	2.9
Support Services	441	2.8
Total	10,341	63.2

Debt Securities

At December 31, 2009, of the debt securities held by the UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, 91.9 per cent were issued by corporations and overseas governments other than the US, 7.2 per cent were issued or guaranteed by the UK government and 0.9 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, 2009, in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At December 31, 2009	
	Market Value (£ million)	(%)
Securities maturing:		
Within one year	1,263	2.1
Over one year and up to five years	8,986	14.8
Over five years and up to ten years	14,253	23.4
Over ten years and up to fifteen years	8,926	14.7
Over fifteen years	27,483	45.0
Total debt securities	60,911	100.0

The following table shows debt securities by rating:

	At December 31, 2009 Market Value (£ million)	(%)
S&P AAA	13,628	22.4
S&P AA+ to AA-	5,651	9.3
S&P A+ to A-	17,785	29.2
S&P BBB+ to BBB-	11,189	18.4
S&P Other	2,165	3.5
	50,418	82.8
Moody's Aaa	459	0.8
Moody's Aa1 to Aa3	275	0.4
Moody's A1 to A3	800	1.3
Moody's Baa1 to Baa3	815	1.3
Moody's Other	339	0.6
	2,688	4.4
Fitch	1,022	1.7
Other	6,783	11.1
Total debt securities	60,911	100.0

Real Estate

At December 31, 2009, Prudential's UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, had £9,977 million of investments in real estate. The following table shows the real estate portfolio by type of investment. The real estate investments are shown at market value in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At December 31, 2009 Market Value (£ million)	(%)
Office buildings	4,427	44.4
Shopping centers/commercial	3,540	35.5
Retail warehouses/industrial	1,472	14.8
Development	20	0.2
Other	518	5.1
Total	9,977	100.0

Approximately 41.4 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 39.2 per cent located throughout the rest of the UK and the remaining 19.4 per cent located overseas.

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

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a desired investment spread between the yield on the portfolio assets and the rate credited on policyholder liabilities. Interest rate scenario testing is continually used to monitor the effect of changes in interest yields on cash flows, the present value of future profits and interest rate spreads.

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

Investments

The following table shows total investments relating to the US insurance operations at December 31, 2009.

	At December 31, 2009		
	Variable annuity separate account assets	Fixed annuity, GIC and other business	Total
		(£ million)	
Investment properties		33	33
Financial investments:			
Loans		4,319	4,319
Equity securities	20,639	345	20,984
Debt securities		22,831	22,831
Other investments		955	955
Deposits		454	454
Total financial investments	20,639	28,904	49,543
Total investments	20,639	28,937	49,576

The following table further analyzes the insurance investments of the US insurance operations, excluding the separate account investments supporting the variable annuity business, at December 31, 2009.

	December 31, 2009	
	(£ million)	(%)
Non-institutional		
Investment properties	33	0.1
Loans	3,916	13.5
Equity securities	270	0.9
Corporate securities	14,881	51.4
Residential mortgage-backed securities	3,072	10.7
Commercial mortgage-backed securities	1,805	6.2
Other debt securities	862	3.0
Total debt securities	20,620	71.3
Other investments	955	3.3
Deposits	454	1.6
Total non-institutional	26,248	90.7
Institutional		
Investment properties		
Loans	403	1.4
Equity securities	75	0.3
Corporate securities	1,574	5.5
Residential mortgage-backed securities	244	0.8
Commercial mortgage-backed securities	299	1.0
Other debt securities	94	0.3
Total debt securities	2,211	7.6
Other investments		
Deposits		
Total institutional	2,689	9.3
Total		
Investment properties	33	0.1
Loans	4,319	14.9
Equity securities	345	1.2
Corporate securities	16,455	56.9
Residential mortgage-backed securities	3,316	11.5
Commercial mortgage-backed securities	2,104	7.2
Other debt securities	956	3.3
Total debt securities	22,831	78.9
Other investments	955	3.3
Deposits	454	1.6
Total	28,937	100.0

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, 2009, the US insurance operations had £16,455 million of corporate securities representing 56.9 per cent of US insurance operations total investments excluding separate account investments. Of the £16,455 million, £13,338 million consisted of debt securities that are publicly traded or trade under Rule 144A under the Securities Act of 1933, as amended ("Rule 144A") and £3,117 million consisted of investments in non-Rule 144A privately placed fixed income securities.

For statutory reporting in the United States, debt securities are classified into six quality categories specified by the Securities Valuation Office of the National Association of Insurance Commissioners ("NAIC"). The categories range from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated Classes 1-5. Securities in or near default are designated as Class 6. Securities designated as Class 3, 4, 5 and 6 are non-investment grade securities. Generally, securities rated AAA to A by nationally 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, 2009.

	At December 31, 2009	
	Book Value (£ million)	(%)
NAIC Class Designation		
1	**5,067**	**38.0**
2	**7,508**	**56.3**
3	**598**	**4.5**
4	**122**	**0.9**
5	**40**	**0.3**
6	**3**	
Total	**13,338**	**100.0**

The following table shows the credit quality of the non-Rule 144A private placement portfolio at December 31, 2009.

	At December 31, 2009	
	Book Value (£ million)	(%)
NAIC Class Designation		
1	**1,084**	**34.8**
2	**1,792**	**57.5**
3	**162**	**5.2**
4	**54**	**1.7**
5	**20**	**0.6**
6	**5**	**0.2**
Total	**3,117**	**100.0**

Residential Mortgage-Backed Securities

At December 31, 2009, the US insurance operations had £3,316 million of residential mortgage-backed securities, representing 11.5 per cent of US insurance operations total investments, excluding separate account investments. At December 31, 2009, 73.9 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, 2009, the US insurance operations had £2,104 million of commercial mortgage-backed securities, representing 7.2 per cent of US insurance operations total investments, excluding separate account investments. 46.0 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, 2009, the US insurance operations had £956 million of other debt securities, representing 3.3 per cent of US insurance operations total investments, excluding separate account investments.

Loans

At December 31, 2009, loans totaled £4,319 million, representing 14.9 per cent of US insurance operations total investments, excluding separate account investments. Of the total, £3,774 million related to commercial mortgage loans, £530 million to policy loans and £15 million to other loans.

Commercial Mortgage Loans

At December 31, 2009, commercial mortgage loans represented 13.0 per cent of US insurance operations total investments, excluding separate account investments. This total included 595 first mortgage loans with an average loan balance of approximately £6.3 million, 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, suburban office, industrial and hotel.

As at December 31, 2009, approximately 31.8 per cent of the portfolio was industrial, 17.8 per cent multi-family residential, 20.5 per cent suburban office, 19.5 per cent retail, 9.5 per cent hotel and 0.9 per cent other. Approximately 14 per cent of the portfolio is collateralized by properties in California, 10.3 per cent by properties in Texas and 7.9 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 1.8 per cent of US insurance operations total investments, excluding separate account investments at December 31, 2009. Policy loans are fully secured by individual life insurance policies or annuity policies and are contractual arrangements made under the policy.

Equity Securities

Equity securities supporting US insurance operations, excluding separate account investments, totaled £345 million at December 31, 2009.

Other

Other financial investments of £955 million, representing 3.3 per cent of US insurance operations total investments, excluding separate account investments at December 31, 2009, were made up of £436 million of limited partnership interests and derivative assets of £519 million.

The largest investment in the limited partnerships category is a £68 million interest in the PPM America Private Equity Fund. The remainder of this category consists of diversified investments in 159 other partnerships managed by independent money managers that generally invest in various equity and fixed income loans and securities.

Investments Relating to Asian Insurance Business

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 Prudential Corporation Asia's investments at December 31, 2009. In this table, investments are valued in accordance with the policies described in note A4 to the consolidated financial statements in Item 18.

	At December 31, 2009						
	With-profits business	Unit-linked assets	Other	Total	Less: assets to cover linked liabilities and external unit holders(a)	Total excluding assets to cover linked liabilities and external unit holders	%
			(£ million)				
Investment properties			11	11		11	0.1
Investments accounted for using the equity method			2	2		2	
Financial investments:							
Loans	781	27	399	1,207	(27)	1,180	9.2
Equity securities	3,691	7,224	267	11,182	(3,630)	7,552	59.0
Debt securities	4,988	2,462	2,534	9,984	(6,503)	3,481	27.2
Other investments	73	44	141	258	(44)	214	1.7
Deposits	14	196	536	746	(379)	367	2.8
Total financial investments	9,547	9,953	3,877	23,377	(10,583)	12,794	99.9
Total investments	9,547	9,953	3,890	23,390	(10,583)	12,807	100

(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.

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, 2009.

	At December 31, 2009	
	Market Value (£ million)	(%)
S&P AAA	904	26.0
S&P AA+ to AA-	632	18.2
S&P A+ to A-	303	8.7
S&P BBB+ to BBB-	115	3.3
S&P Other	596	17.1
	2,550	73.3
Moody's Aaa	51	1.5
Moody's Aa1 to Aa3	303	8.7
Moody's A1 to A3	16	0.5
Moody's Baa1 to Baa3	8	0.2
Moody's Other	15	0.4
	393	11.3
Fitch		
Other	538	15.4
Total debt securities	3,481	100.0

Equity Securities

The following table shows a geographic analysis of equity security investments of Prudential Corporation Asia's long-term insurance fund, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, at December 31, 2009.

	At December 31, 2009	
	Market Value (£ million)	(%)
Hong Kong	4,123	54.6
Singapore	3,224	42.7
Taiwan	47	0.6
Vietnam	26	0.3
Malaysia	126	1.7
Other	6	0.1
Total	7,552	100.0

Description of Property Corporate Property

As at December 31, 2009, Prudential's UK headquartered businesses occupied approximately 35 properties in the United Kingdom, Europe, India, South Africa and Namibia. These properties are primarily offices with some ancillary storage and warehouse facilities. Prudential's global headquarters are located in London. Of the remainder, the most significant are offices in London and Reading in England, Stirling in Scotland and Mumbai in India. The property in Stirling is held on a freehold basis, and is leased by the business from PAC's long-term fund. The rest of the properties occupied by

Prudential's UK based businesses, in the UK, India, South Africa and Namibia, are held leasehold. In Europe, five of the properties are occupied leasehold and the rest (three) are short term serviced offices. The leasehold properties range in size from 500 to 160,000 square feet. Overall, the UK, Europe, Mumbai, South Africa and Namibia occupied property portfolio totals approximately 650,000 square feet.

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

Prudential also holds approximately 74 other leasehold properties in the United Kingdom, spread geographically throughout the country. There are also three in Dublin, Ireland. This surplus accommodation totals approximately 740,000 square feet.

In the United States, Prudential owns Jackson National Life's executive and principal administrative office located in Michigan. Prudential owns a total of six facilities in Lansing, Michigan, which total 550,842 square feet. Prudential also leases premises in Michigan, Colorado, California, Illinois, New York, New Jersey, Georgia, Florida, Wisconsin, Massachusetts, Connecticut, New Hampshire, Pennsylvania, Virginia, Indiana and North Dakota for certain of its operations. Prudential holds 30 operating leases with respect to office space, throughout the United States. The leasehold properties range in size from 500 180,000 square feet. In the United States, Prudential owns and leases a total of approximately 872,584 square feet. 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 24 property assets, ranging from office space, warehouse storage units to land holdings. The breakdown of these owned assets by country is as follows:

- Malaysia: six owned assets All office space totaling 12,315 square feet.
- Philippines: two owned assets All office space totaling 4,278 square feet.
- Singapore: one owned asset All office space totaling 11,883 square feet.
- Thailand: 11 owned assets All land holdings totaling 73,832 square feet.
- Taiwan: four owned assets All office space totaling 12,989 square feet.

Prudential also has (excluding India), a total of 539 operating leases, (expense and intercompany leases), totaling approximately 4.8 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 ICICIPruLife and ICICIPru AMC businesses. The holding comprises approximately 2,450 properties, totaling approximately 3.5 million square feet. There is one owned and occupied asset comprising approximately 30,000 square feet in Mumbai. Prudential Corporation Asia's real estate strategy moving forward involves consolidation of its existing property portfolio to take advantage of the downturn in regional and global markets securing cost savings to the business while maintaining competitive advantage.

The total value of Prudential's owner occupied properties, discussed in the narrative above and as reported in the financial information, is £153 million as at December 31, 2009. This represents less than 0.1 per cent of Prudential's total assets.

Post December 31, 2009, the following two agreements have been approved and either have been or are expected to be completed in due course. The first agreement covers the lease of a property in Tennessee in the United States, which is required to provide additional space to accommodate expansion and an Eastern region sales desk. The initial lease will run for a period of 10 years and six months, commencing in January 2011, based on an initial occupancy of 90,000 square feet. This occupancy will be increased to 150,000 square feet in a phased approach as headcount increases. The second agreement is in respect of the lease of a property in Singapore, with the purpose of allowing the relocation of six other separate office functions to a single location. The leased office space consists of 37,000 square feet with the lease commencing in 2011 and having an initial nine year term.

The characteristics of the agreements mean that both of these leases will be accounted for as operating leases.

There have been no other property transactions subsequent to December 31, 2009 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 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 31 properties which Prudential also occupies, which are accounted for as owner occupied property. These properties are comprised of 24 in Asia, one in the UK and six in the US. The total value of Prudential's owner occupied properties at December 31, 2009 was £153 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, 2009 the total value of investment property was £10,905 million and was comprised 592 properties held by the UK, six held by the US and five held by the Asia business. In total they comprise 4.8 per cent of Prudential's total assets. The UK business' holdings account for over 98 per cent by value of the total investment property.

Prudential is the lessee under 600 operating leases used as office accommodation, comprised of 539 leases held by the Asia, 30 leases held by the US and 31 leases held by the UK business. In the UK, Prudential holds three short-term serviced offices and a further 77 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, wholesalers and financial institutions consider ratings as one factor in determining which provider to purchase financial products from.

As at March 31, 2010:

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

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

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

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

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

Asia

The competitive landscape across the Asia Pacific region differs widely by geographical market, reflecting differing levels of market maturity and regulation. Prudential's competitors include both the subsidiaries of global life insurers and local domestic (including state- owned) entities. Subsidiaries of global life insurance groups that operate in the Asia Pacific region tend to operate in multiple markets in the region, and some currently have top five market shares in a small number of markets. The majority of local domestic life insurers in the Asia Pacific region remain focused on their core home markets. The developed and 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 Asia Pacific, ING and Manulife. Other competitors relevant in one or two of Prudential's key markets include HSBC Life in Hong Kong, Korea Life, Kyobo Life and Samsung Life in Korea, Thai Life in Thailand, Great Eastern in Singapore and Malaysia, and China Life, China Pacific and Ping An in China.

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 AXA Financial Inc., Hartford Life Inc., Lincoln National, AIG, ING, MetLife, Prudential Financial and TIAA-CREF.

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

United Kingdom

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

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

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

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".

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 30, 2010 Jackson had recorded an accrual of $16.7 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.

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, Neilsen 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, Adviser Insight Wholesaler Effectiveness and Service Quality Management Group.

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).

For Prudential Corporation Asia's insurance operations the details of the regulatory regimes are as follows:

Hong Kong The Prudential Assurance Company Limited

<u>*Overview*</u>

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 (the "ICO"). The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority ("IA") for administering the ICO. The principal functions of the IA are to ensure that the interests of policyholders or potential policyholders are protected and to promote the general stability of the insurance industry. The IA has the following major duties and powers: (i) 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 (the "HKFI"). HKFI actively promotes its self-regulatory regime with respect to areas like conduct of insurers and insurance intermediaries, cooling off initiatives, policy replacement and initiative on needs analysis, etc. The Insurance Agents Registration Board of the HKFI is responsible for administering the registration and approval of insurance intermediaries of insurance agents, their responsible officers and technical representatives; and handling complaints against them and providing enquiry services to and handling complaints from the public relating to insurance agents. Please see "The Code of Conduct for Insurers", "The Insurance Claims Complaints Bureau" and "Regulation of Insurance Intermediaries" in this section.

In addition, the selling of MPF products by our 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 operations of Investment Linked products.

Currently, the Hong Kong government is researching into the possibility of making the IA an independent governing body as this would give the OCI more flexibility in its operations and prepare Hong Kong for the risk-based capital regulatory regime. 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 has formulated a proposal to provide statutory backing and appropriate sanctions for customer due diligence and record keeping requirements for financial institutions (including insurance companies), which is expected to enhance the anti-money laundering regulatory regime in Hong Kong. A bill regarding detailed proposal may be introduced into the Legislative Council in 2010.

Authorization under the ICO

Companies carrying on insurance business in or from Hong Kong must obtain authorization from the OCI. Authorization will be granted only to insurers meeting certain requirements set out in section 8 of the ICO, which focuses on, among other things, the following items:

- paid-up capital;
- solvency margin;
- fitness and properness of directors and controllers; and
- adequacy of reinsurance arrangements.

In addition, an insurer must meet certain other criteria contained in the authorization guidelines issued by the OCI which are intended to ensure that the insurer is financially sound and competent to provide an adequate level of services to the insured public. These conditions continue to apply to an insurer after its authorization.

Types of insurance business under the ICO

The ICO requirements vary depending on the type of insurance business being undertaken by an insurer. The ICO defines two main types of business as follows:

- long-term business covers those types of insurance business in which policies are typically in place for long periods and includes life and annuity, linked long-term, permanent health and retirement scheme management policies; and

- general business covers all business other than long-term business, including accident and sickness, fire, property, motor vehicle, general liability, financial loss and legal expenses insurance.

Both types of business defined in the ICO include reinsurance as well as direct insurance business. With the exception of certain capital requirements in the case of pure reinsurers, the authorization criteria are the same for both direct insurers and reinsurers.

An insurer that undertakes both long-term and general business is referred to by the OCI as a composite business insurer.

In addition to these main types of business, the ICO imposes further requirements on insurers conducting insurance business relating to liabilities or risks in respect of which persons are required by law to be insured ("Statutory Business"), including employees' compensation insurance and third party insurance in respect of motor vehicles.

Minimum paid-up capital requirement

Section 8(3)(b) of the ICO sets the following minimum paid up capital requirements for insurers depending on the type of business they intend to undertake:

- general business without Statutory Business: HK$10 million;

- general business including Statutory Business: HK$20 million;

- long-term business: HK$10 million; and

- composite business: with or without statutory businesses HK$20 million.

Solvency margin

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

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

- 20 per cent of premium income/outstanding claims up to HK$200 million; and

- 10 per cent of premium income/outstanding claims in excess of HK$200 million.

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To determine whether a general business insurer meets the solvency margin requirement, its assets are valued in accordance with the Insurance Companies (General Business) (Valuation) Regulation (Chapter 41 G of the Laws of Hong Kong) (the "Valuation Regulation"). The Valuation Regulation prescribes the valuation methods for different types of assets commonly found on an insurer's balance sheet. To ensure a prudent diversification of investments, the Valuation Regulation also stipulates admissibility limits for different categories of assets. The admissibility limits, however, do not apply to assets maintained in Hong Kong pursuant to section 25A of the ICO as described below.

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

To determine whether a long-term business insurer meets the solvency margin requirements, its assets and liabilities are valued in accordance with the Insurance Companies (Determination of Long-Term Liabilities) Regulation (Chapter 41 E of the Laws of Hong Kong), which sets out the bases for the determination of the amount of long-term business liabilities. An insurer is required to adopt prudent provisions and assumptions, particularly on interest rates, when valuing the amount of long-term business liabilities. Among others, valuation methods are specified for calculating the yields on assets and the amount of future premiums payable under an insurance contract.

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

Fit and proper directors and controllers

Section 8(2) of the ICO requires that all directors and controllers of an insurer must be "fit and proper" persons to hold such positions. Section 9 of the ICO defines an insurer's controllers as including, among others, a managing director of the insurer or its corporate parent, a chief executive officer of the insurer or its corporate parent (only if the parent is also an insurer), a person in accordance with whose directions or instructions the directors of the insurer or its corporate parent are accustomed to act or who, alone or with any associate or through a nominee, is entitled to exercise, or control the exercise of, 15 per cent or more of the voting power at any general meeting of the insurer or its corporate parent. Sections 13A, 13B and 14 of the ICO also require notification to the OCI of any change in the directors or controllers of an authorized insurer and the prior approval of the OCI for the appointment of certain controllers, including the chief executive of an insurer.

Although the term "fit and proper" is not defined further in the ICO, the OCI has issued a guidance note which sets out those factors that the OCI will take into account in applying the "fit and proper" test to the directors or controllers of an insurer. These factors include a director's or controller's financial status, character, reputation, integrity, reliability, qualifications and experience regarding the functions to be performed by such director or controller and ability to perform such functions efficiently, honestly and fairly.

Adequate reinsurance arrangements

Section 8(3)(c) of the ICO requires all insurers to have adequate reinsurance arrangements in-force in respect of the risks of those classes of insurance business they carry out, or to justify why such arrangements are not necessary. In considering the adequacy of reinsurance arrangements of an insurer, the OCI will take into account the following factors:

- the type of reinsurance treaties entered into by the insurer;

- the maximum retention of risks by the insurer;
- the security of the reinsurers; and
- the spread of risks among participating reinsurers.

With regard to the spread of risks among reinsurers, the OCI considers that additional risks arise where a reinsurer is a related company of the insurer. To address this concern, the OCI has issued a guidance note on reinsurance with related companies, which sets out the criteria to be used in determining the adequacy of such arrangements. The OCI will consider a related reinsurer to provide adequate security if any of the following requirements are met:

- the reinsurer is itself authorized under the ICO;
- the reinsurer or any one of its direct or indirect holding companies has received an adequate rating from a credit rating agency (currently the OCI specifies an Insurer Financial Strength Rating of AA- or above by S&P, Aa3 or above by Moody's or A+ or above by A.M. Best, or equivalent rating); or
- the reinsurer or any one of its direct or indirect holding companies is otherwise considered by the OCI as having a status comparable to the above.

In the event that none of these requirements is met by a related reinsurer, the OCI will restrict the amount of net reinsurance it deems recoverable from that reinsurer when assessing the cedent's financial position, unless it determines that acceptable collateral security, such as an irrevocable and permanently renewable letter of credit, is in place in respect of the arrangement with that reinsurer.

Maintenance of assets

Section 25A of the ICO requires insurers carrying on general business to maintain assets in Hong Kong in respect of the liabilities arising from their Hong Kong business. The minimum amount of assets to be maintained is calculated on the basis of an insurer's net liabilities and the proportion of its solvency margin requirement attributable to its general business in Hong Kong, taking into account the level of reinsurance that has been entered into by the insurer in respect of its liabilities.

Sections 22 to 23 of the ICO require insurers carrying on long-term business to keep separate accounts for different classes of long-term business and to maintain certain levels of assets calculated on the basis of their solvency margins in respect of each class of business in funds that are applicable only to that particular business.

The OCI has also issued a guidance note on reserve provisioning for Class G of long-term business (defined in the ICO as long-term business involving retirement scheme contracts which provide for a guaranteed capital or return) to reinforce and enhance the required standard of provision for Class G business. Policies classified under Class G of long-term business are mainly offered as retirement scheme contracts under retirement schemes regulated pursuant to the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong) (the "MPFSO") and the Occupational Retirement Schemes Ordinance (Chapter 426 of the Laws of Hong Kong) (*the "ORSO"*). An insurer authorized to carry on long-term business is required, among other things, to maintain a separate long-term business fund for its Class G business carried on in or from Hong Kong. In respect of the Class G business fund, the OCI requires that the value of the assets contained in the fund are in the aggregate not less than the amount of the liabilities attributable to such business.

Accounting and reporting requirements

The ICO requires insurers to maintain proper books of accounts which must exhibit and explain all transactions entered into by them in the course of their business. Insurers must submit information including audited financial statements, a directors' report and statistics relating to the valuation of their insurance business and outstanding claims to the OCI on an annual basis.

Insurers carrying on long-term business are also required to appoint an actuary to conduct an annual actuarial investigation and submit a report to the OCI on their financial condition in respect of the long-term business. The appointed actuary is responsible for advising on all actuarial aspects of the financial management of an insurer's long-term business including proper premium setting, a prudent reserving policy, a suitable investment allocation, appropriate reinsurance arrangements and due reporting of irregularities to the OCI.

Corporate governance of authorized insurers

The OCI has issued a guidance note on the corporate governance of authorized insurers, which aims to enhance the integrity and general well-being of the insurance industry by providing assistance to authorized insurers for the evaluation and formulation of their internal practices and procedures. This guidance note sets out the minimum standard of corporate governance expected of authorized insurers and applies to both authorized insurers incorporated in Hong Kong and authorized insurers incorporated outside Hong Kong where 75 per cent or more of their annual gross premium income pertains to their Hong Kong insurance business, unless written consent for exemption has been obtained from the OCI. This guidance note covers the following key items:

- structure of senior management;
- roles and responsibilities of the Board of directors;
- board matters;
- board committees;
- internal controls;
- compliance with laws and regulations; and
- servicing of clients.

Irrespective of the proportion of an overseas insurer's Hong Kong insurance business, the OCI expects such an insurer to observe strictly any applicable guidelines on corporate governance promulgated by its home regulatory authority.

Asset management

In order to ensure that an insurer will meet its contractual liabilities to policyholders, its assets must be managed in a sound and prudent manner, taking into account the profile of liabilities and risks of the insurer. The OCI has issued a guidance note on asset management by authorized insurers, which is adopted from the paper "Supervisory Standard on Asset Management By Insurance Companies" as approved by the International Association of Insurance Supervisors in 1999. This guidance note applies to both an insurer incorporated in Hong Kong and the Hong Kong branch of an insurer incorporated outside Hong Kong whose investment in financial assets exceeds HK$100 million. This guidance note provides a checklist for assessing how insurers should control the risks associated with their investment activities and includes guidance and commentary on the following key items:

- investment process, policy and procedures;

overall asset management strategies;

investment mandate given by the Board of directors to senior management;

audit in respect of the insurer's asset management functions;

- risk management functions; and
- internal controls.

In order to assess how insurers control the risks associated with their investment activities, the OCI may periodically request information from insurers, including accessing information through on-site inspections and discussion with insurers.

Power of intervention

The IA is empowered under Part V of the ICO to intervene in an insurer's business and take appropriate actions in the following circumstances:

- where the IA considers that the exercise of this power is desirable for protecting the interests of existing and potential policyholders against the risk that the insurer may be unable to meet its liabilities or to fulfill the reasonable expectations of existing or potential policyholders;
- where it appears to the IA that the insurer or its corporate parent has failed to satisfy any of its obligations under the ICO;
- where it appears to the IA that the insurer has provided misleading or inaccurate information to it for the purposes of the ICO;
- where the IA is not satisfied as to the adequacy of the insurer's reinsurance arrangements;
- where the IA is not satisfied with the financial condition of the insurer or its compliance position with the prescribed regulatory benchmark or requirements in respect of, amongst others, its assets and liabilities matching position, reserving level or financial projections; or
- where the insurer fails its ongoing authorization requirements in respect of share capital and "fitness and properness" of its directors and controllers.

The IA may also intervene in an insurer's business, whether or not any of the above circumstances exist, at any time during the five year period following authorization of the insurer or a person becoming a controller of an insurer.

The actions that the IA may take in intervening in an insurer's business include:

- restrictions on the insurer effecting new business;
- limits on the amount of premium income an insurer may receive during a specified period in respect of certain classes of business;
- restrictions on types of investments an insurer may make, or requirements that the insurer realize certain types of investments within a specified period;
- requirements that an insurer maintain assets in Hong Kong equal to a specified portion of the liabilities arising from its Hong Kong business, and that these assets be held in the custody of a trustee approved by the IA;

the appointment of a manager to assume control of an insurer; and

requirements that the insurer has to conduct a special actuarial investigation on its long term business, to produce information and to accelerate submission of returns by the insurer.

The Code of Conduct for Insurers

As part of the self-regulatory initiatives taken by the industry, the HKFI has published The Code of Conduct for Insurers. This code seeks to: describe the expected standard of good insurance practice in the establishment of insurance contracts and claims settling; promote the disclosure of relevant and useful information to customers; facilitate the education of customers about their rights and obligations under insurance contracts; foster a high professional standard in the transaction of insurance business; and encourage insurers to promote and enhance the industry's public image and standing. This code applies to all general insurance members and life insurance members of the HKFI and applies to insurance effected in Hong Kong by individual policyholders resident in Hong Kong and insured in their private capacity only. As a condition of membership of the HKFI, all general insurance members and life insurance members undertake to abide by this code and use their best endeavors to ensure that their staff and insurance agents observe its provisions.

The Insurance Claims Complaints Bureau

The Insurance Claims Complaints Bureau was established to implement self-regulation in the interpretation and handling of insurance claims complaints arising from all types of personal insurance policies taken out by residents of Hong Kong. The Insurance Claims Complaints Panel was established by the Insurance Claims Complaints Bureau with the objective of providing independent and impartial adjudication of complaints between insurers and their policyholders. The Insurance Claims Complaints Panel is in charge of handling claims complaints from both policyholders themselves and their beneficiaries and rightful claimants. The Insurance Claims Complaints Panel, in making its rulings, is required to act in conformity with the terms of the relevant policy, general principles of good insurance practice, any applicable rule of law or judicial authority, and any codes and guidelines issued from time to time by the HKFI.

Regulation of insurance intermediaries

Insurance intermediaries are defined under the ICO as either insurance agents or insurance brokers. The key difference between the two types of insurance intermediaries is that insurance agents act as agents or subagents of insurers, while insurance brokers act as agents of policyholders and potential policyholders. Both are subject to a self-regulatory system supported by provisions contained in Part X of the ICO.

Under the ICO, a person is prohibited from holding itself out as an insurance agent or insurance broker unless such person is properly appointed or authorized. A person is also prohibited from holding itself out as an appointed insurance agent and an authorized insurance broker at the same time. It is also an offence under the ICO for an insurer to effect a contract of insurance through, or accept insurance business referred to it by, an insurance intermediary who has not been properly appointed or authorized.

To act as an insurance agent, a person is required to be appointed by an insurer and registered with the Insurance Agents Registration Board established by the HKFI. Under Section 66 of the ICO, an insurer is required to keep a register of appointed insurance agents and to make such register available for public inspection at its registered office (or principal place of business) in Hong Kong, or the registered office of the HKFI. An insurer is required to give the OCI and/or the Insurance Agents Registration Board details of the registration or removal of its appointed insurance agents within seven days of such registration or removal.

An insurer is required to comply with the Code of Practice for the Administration of Insurance Agents issued by the HKFI and endorsed by the OCI pursuant to section 67 of the ICO. The Code of Practice for the Administration of Insurance Agent specifies the rules and procedures governing the registration and de-registration of insurance agents, the power of the Insurance Agents Registration Board to handle complaints and to require insurers to take disciplinary actions against their insurance agents, the "fit and proper" criteria for insurance agents and the minimum requirements of agency agreements. An insurer is responsible for the actions of its appointed insurance agents in their dealings with clients in respect of the issue of insurance contracts and related insurance business. The OCI has the power to direct the de-registration of an appointed insurance agent.

Taiwan PCA Life Assurance Company Limited

Currently, composite licenses to sell both life and non-life insurance are not granted and PCA Life Assurance Company Limited is licensed for life insurance business only.

The Financial Supervisory Commission (the "FSC") is responsible for regulating the entire financial services sector. The FSC's responsibilities include supervision, examination and investigation. The Insurance Bureau (the "IB") of the FSC is responsible for the insurance sector.

Taiwanese laws are based on a civil code model and each competent authority is given powers to develop and issue regulation on specific topics or issues. Many of the current insurance regulations were revised and promulgated in 2007 in response to the significant amendment of the Insurance Act in 2007. Similar to many Asian countries, the provisions of insurance regulations tend to be prescriptive.

In 2007, the FSC promulgated the guidance notes related to foreign currency denominated traditional life business. Insurers must satisfy several requirements related to disciplinary performance, risk-based capital, risk management controls, and complaints efficiency in order to qualify. At this stage, only life insurance and annuity products denominated in US dollars are permitted. Prior approval from the Central Bank and IB is required and the underlying foreign portfolio is also subject to the 45 per cent foreign investment limit as per the Insurance Act.

In 2007, the FSC promulgated a regulation governing the engagement by insurers in insurance trust business. Before engaging in insurance trust business, an insurer is required to meet certain qualifying requirements and to apply to the IB for approval. The insurer may invest the entrusted money into cash, bank deposits, bonds, financial debentures, short-term bills, and other instruments otherwise approved by the IB. Further, it is required not only to segregate the trust assets from its own assets by establishing a separate account for the trust assets, but also to build a risk management and internal control system to ensure the proper management of the business.

Generally, the insurance law and regulations focus mainly on administrative supervision of insurance operations rather than conduct of business. An exception is the Regulation, Guideline and Self-Discipline Regulation related to the sale of investment-linked insurance products, where specific requirements, such as the obligations on insurers to disclose to prospective customers the costs of the product and the risks involved, to set up "Know Your Customers" operating principles and to perform needs analysis in identifying risk appetite and financial objectives of policy applicants are established. Other requirements include establishing risk classes for structured notes products, sample testing of new business to determine appropriateness of sales process and policy suitability, and conducting regular inspection to avoid the use of inappropriate sale materials.

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 underwent major change on February 29, 2008, when the Financial Supervisory Commission was integrated with the Financial Policy Bureau of the former Ministry of Finance and Economy to become the Financial Services Commission (the "FSC"). As Korea's principal supervisory authority, the new FSC is given broad statutory mandate to carry out three key functions, financial policy formulation, financial institution and market oversight, and anti-money laundering. The

FSC thus has the statutory authority to draft and amend financial laws and regulations and issue regulatory 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), which was also integrated into the FSC as part of the reorganization, leads the government's anti-money laundering and counter-terrorism financing efforts.

Currently, the country does not permit a company to operate both life and non-life insurance at the same time. The Republic of Korea operates a civil law system, with the FSC prescribing many detailed regulations for insurers to comply with. In the past, the FSC has also been very interventionist in setting and enforcing rules on the insurance industry. However, the style of regulation has been gradually changing along with the trend of liberalization of financial services. This is most pronounced with the regulator focusing on the deregulation in asset management and product design activities. Furthermore, the FSS is setting an aggressive insurance supervisory agenda that would strengthen supervision while promoting deregulation. The regulator is moving towards risk-based supervision focusing on various risks of insurers' operations. As part of the shift to risk-based supervision, the FSS has introduced the Risk Assessment and Application System ("RAAS") to assess insurers' various risks and relevant internal control and Risk-Based Capital ("RBC") solvency requirement.

Both the Insurance Business Act and Insurance Business Supervisory Regulations have not been very specific on the entity's responsibilities for the suitability of products. There is no explicit requirement for an insurer to consider the suitability of the product for the potential customer. However, on December 18, 2008, the FSC introduced a revised bill for an Insurance Business Act to the National Assembly (Korea's legislative body) which will become effective provided it is passed in the National Assembly. It establishes the definition of an insurance product and also strengthens consumer protection measures. It overhauls the examination procedure for an insurance product and also establishes a basis for fair competition among businesses in various financial sectors. The revised bill is still pending in the National Assembly.

The FSS also operates a Consumer Protection Department and a Dispute Settlement Department in the Customer Protection Division to resolve and prevent customer complaints and disputes relating to insurance companies.

Korea currently allows many different forms of channels for distributing life insurance products including brokers, agents, telemarketing, direct mailing, bancassurance and mass media television selling.

Capital requirements

In respect of an insurer's capital adequacy requirement, Korea previously had a solvency margin requirement. Effective from April 1, 2009, Korea adopted a risk-based capital requirement to replace the solvency margin requirement. A two-year transition period between the two requirements is currently in place, which means that both requirements will be enforced in parallel until March 31, 2011. During this transition period, insurers have the discretion to elect which of the two requirements to comply with. From April 1, 2011, it will be mandatory for all insurers to comply with the risk-based capital requirement.

The solvency margin requirement under the Korean Insurance Business Act is intended to ensure that insurers maintain a solvency surplus against future liabilities, and the requirement is based on the European Union solvency ratio model. In particular, all insurers, including branches of foreign insurers, must maintain net assets of equal or greater value to an amount calculated on the basis of the liabilities that they insure such that they maintain a solvency margin ratio of at least 100 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 are not currently taken into consideration under the solvency margin requirement.

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

Reserve requirements

In order to satisfy the payment obligations of an insurer's policies, which include claims, reimbursements and dividends payable to policyholders, an insurer must establish and maintain a separate liability reserve in respect of each of the following: insurance premiums reserve, unexpired insurance premiums reserve, insurance claim payments reserve, dividends reserve, profit dividends reserve, dividend insurance loss maintenance reserve and reinsurance premiums reserve. However, if an insurer acquires reinsurance of its liability under an insurance contract and such reinsurance satisfies stipulated regulatory conditions, the liability reserve in respect of that insurance contract need not be maintained by the insurer.

Statutory fund

Under the Depositor Protection Act of Korea, the Korea Deposit Insurance Corporation insures certain liabilities (the "KDIC Insured Liabilities") owed to the public in Korea by financial institutions. The KDIC Insured Liabilities of an insurer under the Depositor Protection Act of Korea include insurance premiums, surrender values and insurance claims payable by an insurer to an individual policyholder. Under the Depositor Protection Act of Korea, all insurers are required to contribute an annual insurance premium to the Korea Deposit Insurance Corporation at a rate determined pursuant to the Depositor Protection Act, up to a maximum of 0.5 per cent of an insurer's KDIC Insured Liabilities in that year. The annual insurance premium payable by an insurer is currently approximately 0.16 per cent of the average of the insurer's annual premium income and liability reserve. Under the current rules, the Korea Deposit Insurance Corporation insures only up to a total of Korean Won 50 million per individual against each insurer.

Asset management

Subject to certain exceptions, the Insurance Business Act provides for caps on the proportion of an insurer's total investments that can be held in particular classes of assets or exposure to particular counterparts. Such caps may be revised by the FSC from time to time as it deems necessary.

The Insurance Business Act restricts, among other things, certain asset management transactions such as the making of speculative loans, loans for the acquisition of the insurer's own securities, loans for political funds and foreign exchange and financial derivative transactions that fail to meet the requirements of the FSC.

Use of insurance funds by an insurer is subject to certain restrictions, including a general prohibition on an insurer offering its assets as security or guaranteeing debts of any other person (unless permitted under the Insurance Business Act), and a general prohibition on an insurer owning more than 15 per cent of the voting shares of another corporation unless that corporation is a subsidiary of the insurer and the approval of the FSC has been obtained.

Reinsurance

Pursuant to the Insurance Business Supervisory Regulation issued pursuant to the Insurance Business Act, an insurer will be given credit for the purposes of its solvency margin and risk-based capital calculations only for ceded reinsurance covering a maximum of 50 per cent of its total insurance liabilities. Any reinsurance ceded by an insurer in excess of 50 per cent will be disregarded in calculating its capital requirements. In addition, insurers are required to give notice to the FSS within one month after execution of (or change of) every reinsurance treaty where the reinsurance treaty determines reinsurance premiums with reference to an expected rate of investment return, or the reinsurance treaty provides for a limitation of the reinsurer's liability.

Regulation of products

Any new product (including its terms, introduction to the market and premium rates and their calculation methods) is subject to *ex ante* or *ex post* review by the FSS ("Process for File & Use" or "Use & File", depending on the product). In addition, an insurer must disclose on its internet website certain information, including a summary of its products, insurance terms, applicable interest rates and, in relation to the premium rates of variable insurance products, the calculation method for such rates and information on any designated accounts for such variable insurance products.

Restrictions on foreign insurers

In the event that the head office of a Korean branch of a foreign insurer is closed due to a merger or transfer of business in its home jurisdiction, is subject to suspension or revocation of its insurance licence by any foreign financial supervisory agency on grounds of illegal conduct or unfair business practices, or suspends its insurance business or ceases to operate, the insurance licence of that insurer's Korean branch may be revoked.

A branch of a foreign insurer must hold assets located in Korea equivalent to the liability reserve sufficient to fulfill all insurance contracts written in Korea. If the amount of assets located in Korea held by the branch of a foreign insurer is determined to be insufficient based on the annual audited accounts, the assets must be supplemented through an injection of capital within 60 calendar days. In the event an insurer is instructed to remedy any deficiency following a decision of the FSS in consultation with the FSC, remedial action must be taken within 30 calendar days.

Financial reporting requirement

An insurer is required to close its books on March 31, of each year and submit its financial statements, including supplementary statements, audit reports, a statement of repaid funds and a statement of interest on funds, to the FSC within three months.

Singapore Prudential Assurance Company Singapore (Pte.) Limited

Overview

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

Under the Singapore Insurance Act, the MAS is responsible for insurance company regulation and supervision. In order to sell insurance in Singapore, companies need to be registered with the MAS. The MAS also has responsibility for supervising compliance with anti-money laundering ("AML") provisions, though suspicious transactions must be notified to the Commercial Affairs Department, an enforcement agency of the Singapore Police Force. In 2007, new regulations were introduced to strengthen further the AML requirements. They were revised in 2009.

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

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

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

The MAS has also issued Notices that cover the market conduct standards for life insurers including such areas as appointing and training representatives, maximum tier structure, loans and advances, disciplinary action, disclosure, sales process and replacement of life policies. In addition, the MAS has recently issued a set of guidelines entitled "Guidelines on Fair Dealing Board and Senior Management Responsibility for Delivering Fair Dealing Outcomes to Consumers".

Capital requirements

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

(a) the sum of:

(i) the aggregate of the total risk requirement of all insurance funds established and maintained by the insurer under the Singapore Insurance Act; and

(ii) where the insurer is incorporated in Singapore, the total risk requirement arising from the assets and liabilities of the insurer that do not belong to any insurance fund established and maintained under the Singapore Insurance Act (including assets and liabilities of any of the insurer's branches located outside Singapore); or

(b) a minimum amount of 5 million Singapore Dollars.

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

Statutory deposit

A person carrying on insurance business in Singapore as an insurer, while registered in respect of any class of insurance business, is required to have at all times in respect of that class of business a deposit (in assets of such nature as the MAS may specify) with the MAS of a value of not less than 500,000 Singapore Dollars. Subject to the approval of the MAS, a bank covenant for an equivalent amount may be provided to the MAS in lieu of the deposit.

Statutory fund

The MAS maintains a Policy Owners' Protection Fund for the purposes of indemnifying, assisting or protecting policy owners and others who may be prejudiced by the inability of registered insurers to meet their liabilities under life policies and compulsory insurance policies issued by such insurers. For the purposes of funding the Policy Owners' Protection Fund, the MAS may impose a levy on registered insurers. Among other things, in order to secure continuity of insurance for every policy owner of a registered insurer in liquidation or in financial difficulties who is a policy owner in respect of a life policy which was a Singapore policy or an offshore policy and not being a contract of reinsurance, the MAS may take measures to secure or facilitate the transfer of the life business of the insurer, or part of that business, to another registered insurer or to secure the issue by another registered insurer to the policy owners of life policies in substitution of their existing policies.

Asset management

The MAS Notice 104 "Use of Derivatives for Investment of Insurance Fund Assets" provides that insurers are only permitted to enter into or effect derivative transactions for the purposes of hedging and efficient portfolio management. In addition, insurers are prohibited from taking uncovered positions in derivatives.

The MAS Notice 105 "Appointment of Custodian and Fund Manager" requires a registered insurer to file with the MAS a list of all assets of all insurance funds established and maintained under the Singapore Insurance Act by the insurer where documents evidencing title are kept by custodians for the insurer as at the end of that accounting period, to apply best practice standards in appointing overseas custodians, and to notify the MAS prior to the appointment of a fund manager or revocation of such appointment.

The MAS Notice 317 "Asset Management of Life Insurance Funds" sets out the basic principles that govern the oversight of the asset management process of life insurance funds. It requires insurers to establish an investment committee and prescribes the main elements that must be incorporated in the investment policy of an insurer carrying on life insurance business.

The MAS Notice 320 "Management of Participating Life Insurance Business" requires an insurer which has established or will be establishing a participating fund to put in place an internal governance policy which shall include information on, among other things, the investment of participating fund assets.

Separate accounts requirement

Every registered insurer is required to establish and maintain a separate insurance fund (a) for each class of insurance business carried on by the insurer that (i) relates to Singaporean policies and (ii) relates to offshore policies; (b) for its investment-linked policies and for its non-investment-linked policies; and (c) if no part of the surplus of assets over liabilities from an insurer's non-participating policies is allocated by the insurer by way of bonus to its participating policies, in respect of non-investment-linked policies (i) for participating policies and (ii) for non-participating policies.

The MAS Notice 101 "Maintenance of Insurance Funds", the MAS Notice 313 "Basis for Establishing Separate Funds for Participating and Non-participating Policies" and the MAS Guidelines on Implementation of Insurance Fund Concept provide further guidance and requirements on the establishment and maintenance of insurance funds and the segregation of the assets of registered insurers in Singapore as required under the Singapore Insurance Act.

The solvency requirement in respect of an insurance fund must at all times be such that the "financial resources" of the fund are not less than the "total risk requirement" of the fund. Each of the "financial resources" of an insurance fund and its "total risk requirement" is determined, and assets are valued, in accordance with the requirements of the Insurance (Valuation and Capital) Regulations 2004. The MAS has the authority to direct that the insurer satisfy fund solvency requirements other than those that the insurer is required to maintain under the Singapore Insurance Act if the MAS considers it appropriate.

The assets in the insurance fund shall only be applicable to meet such part of the insurer's liabilities and expenses as is properly attributable (excluding certain levies).

Reinsurance

The MAS Notice 114 "Reinsurance Management Strategy" sets forth the guiding principles relating to the oversight of the reinsurance management process of insurers and includes the principle that the Board of directors and senior management of an insurer are required to develop, implement and maintain a reinsurance management strategy appropriate to the operations of the insurer to ensure that the insurer has sufficient capacity to meet obligations as they fall due.

The MAS Notices 208 and 316 "Financial Reinsurance" impose certain requirements in respect of financial reinsurance for insurers registered to carry on general business and life business respectively. These include guidelines and mandatory requirements on, among other things, prudent management oversight, disclosure and reporting obligations and transfers of insurance risk.

Regulation of products

A direct insurer registered to carry on life business may only issue a life policy or a long-term accident and health policy if the premium chargeable under the policy is in accordance with rates fixed with the approval of an appointed actuary or, where no rates have been so fixed, is a premium approved by the actuary.

Before offering certain new products, an insurer is required under the MAS Notice 302 "Product Development and Pricing" to obtain approval from the MAS. For products that do not require the MAS's approval, an insurer should notify the MAS of any such product launched within a prescribed period. Such request or notification shall include information on, among other things, the tables of premium rates.

Appointment and duties of actuaries

Insurers carrying on life and general business are required to appoint an actuary approved by the MAS, and are required to (a) in respect of their life business, have an investigation made by an actuary approved by the MAS into the financial condition of that business; and (b) in respect of their general business, have an investigation made by an actuary approved by the MAS into their liabilities in respect of insurance policies. Reports of such investigations must be lodged with the MAS.

The appointed actuary is responsible for, among other things, reporting to the principal officer of a life insurer on various matters including matters which in the actuary's opinion have a material adverse effect on the financial condition of a life insurer. In the event a life insurer fails to take steps to rectify any matter reported by the actuary to its principal officer, the actuary is required to report directly to the MAS.

Financial reporting requirements

The Insurance (Accounts and Statements) Regulations 2004 sets forth various reporting requirements and prescribes the forms in which the relevant returns and statements of a registered insurer are to be made. The regulatory framework also prescribes the valuation of assets and liabilities of an insurance fund, as well as the valuation of life and general insurance policy liabilities at a policy-by-policy level.

A registered insurer is required to file with the MAS, among other things, (a) for each quarter and each accounting period, statements for each insurance fund established and maintained under the Singapore Insurance Act; (b) a report by an actuary on its investigation into the valuation of policy liabilities and the financial soundness in respect of the insurer's life insurance business; (c) a report by an actuary on its investigation into the valuation of policy liabilities in respect of the insurer's general insurance business; (d) statements on the fund solvency requirement and capital adequacy requirement; (e) an auditor's report and supplementary report (if any); and (f) any other information the MAS may require for the discharge of its functions under the Singapore Insurance Act.

In the case of a company incorporated or established outside Singapore, the financial audit need not extend beyond the business for which an insurance fund is maintained under the Singapore Insurance Act. Such a registered insurer incorporated outside Singapore is required to file with the MAS for each fiscal year, in respect of the insurer's global business operations, a statement of the financial position of the insurer as of the end of that fiscal year. A registered insurer incorporated in Singapore is required to file with the MAS statements in respect of its global business operations for each quarter and each accounting period.

In addition, the MAS Notice 306 "Market Conduct Standards for Life Insurers Providing Financial Advisory Services" and the MAS Notice 318 "Market Conduct Standards for Direct Life Insurer as a Product Provider" require insurers to submit information on their businesses to the MAS annually.

Malaysia Prudential Assurance Malaysia Berhad

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 the consumers' interests.

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

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.

Reserve requirements

The RBC framework requires the appointed or signing actuary of a life insurer to determine the required amount of policy reserves for the life insurance liabilities and the general insurance signing actuary to determine the level of reserves for general insurance business. The basis used should be no less stringent than that prescribed in the RBC framework.

Separate accounts requirements

An insurer is required to establish and maintain separate insurance funds for its Malaysian policies and for its foreign policies and, where directed by BNM, for different categories or description of its insurance business or classes of policies. An insurer is required to pay into the applicable insurance fund all money received in respect of policies of a class to which the insurance fund relates, keep the assets of its insurance fund separate from its other assets and maintain assets of equivalent or higher value than the liabilities of that insurance fund. An insurer may apply the assets of an insurance fund only to meet such of its liabilities and expenses as are properly attributable to that insurance fund.

An insurer may withdraw the surplus from a general insurance fund where there is a surplus of assets over liabilities at the end of a fiscal year, subject to any instrument or contract binding the licensed insurer or its constituent documents. For a life insurance fund, upon the actuarial valuation and recommendation by the appointed actuary, the life insurer may allocate a part of the surplus attributable to participating and non-participating policies by way of a bonus paid to participating policies and for transfer out of that life insurance fund to the shareholders' fund, subject to such limits and such proportions as may be prescribed.

Asset management

The investment limits on individual asset classes and exposure limits to counterparties are provided in the RBC framework. The RBC framework also sets out the supervisory expectations in respect of the investment of an insurer's assets.

Reinsurance

A licensed insurer's reinsurance arrangements must be consistent with sound insurance principles. The general principles to be observed in a reinsurance arrangement are the appropriateness of retention level, security of reinsurers, spread of reinsurers and appropriateness of reinsurance treaties. An insurer is required both to design its reinsurance program in line with its exposure and portfolio of business, taking into account, among other things, its insurance risk profile and the concentration of its business and to ensure that its reinsurance arrangements provide adequate protection for all classes of business underwritten to enable it to pay its liabilities as they come due, In placing reinsurance in respect of general insurance, an insurer must accord priority to local reinsurers up to such local reinsurers' full retention capacity before securing reinsurance support from foreign insurers.

Financial reporting requirements

In general, insurers are required to submit each of the following to BNM within a specified timeframe: (a) audited annual accounts; (b) an auditor's report and certificate; (c) an appointed actuary's report and certificate; (d) a report on the action taken by the Board of directors on the auditor's report; (e) the Board of directors' report on its operations; and (f) quarterly returns of each fiscal year. BNM has also issued guidelines which require an insurer to submit additional reports which, among other things, relate to such insurer's investments, claims, reinsurance, solvency and capital adequacy.

BNM has announced that it is undertaking a comprehensive review of the Insurance Act 1996. Detailed proposals of the legislative changes are expected to be finalized by the end of 2010.

Malaysia (Takaful business) Prudential BSN Takaful Berhad

Prudential BSN Takaful Berhad ("Prudential Takaful") (a Prudential joint venture with Bank Simpanon 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 insurance companies.

Takaful in Malaysia is considered to be part of mainstream mercantile law, and hence part of civil law, and is therefore subject to the civil court structure of Malaysia. It is not regulated by Shariah law in Shariah courts. However, the operation system of a Takaful operator must conform to the rules and requirements of Shariah as regulated in the Takaful Act 1984, which elevates the Shariah Advisory Council to the position as the sole authority on Shariah matters. A Takaful operator is required to establish a Shariah advisory body approved by the Director General of Takaful to advise on the operations of its Takaful business. To strengthen further the Shariah and legal infrastructure, the Guidelines on the Governance of Shariah Committee for Islamic Financial Institutions were issued in 2004 to streamline the functions and duties of Shariah Committee of Takaful operators and strengthen their independence. BNM has indicated that, in line with efforts to enhance the Shariah governance of

Islamic financial institutions, a new Shariah governance framework will be issued in 2010 to provide comprehensive guidance on the roles and responsibilities of the Shariah committee and the Board management of Islamic financial institutions in ensuring that the operations of the Islamic financial institutions are in compliance with Shariah principles.

Although the Takaful operator is also governed by the same regulator (BNM), the industry is regulated slightly differently from insurance companies. The differences relate in the main to matters where the regulators still find the Takaful operators not ready. For example, the risk-based capital framework that has been implemented for insurers has not been implemented yet for Takaful operators given the nature of the business (i.e. Shariah compliant) and the maturity of the industry. However, as reported in the Financial Stability and Payment Systems Report 2009, the conceptual parameters of the capital model and development of the valuation components for family and general Takaful business under the RBC Framework for Takaful operators ("RBCT") has been substantially completed. Consultation with the industry on the detailed RBCT and impact assessments will commence in 2010 with a target timeline for implementation of the framework on a parallel basis by 2011. In other areas regulation is similar to the insurance industry.

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

BNM has announced that it is undertaking a comprehensive review of the Takaful Act 1984. Detailed proposals of the legislative changes are expected to be finalized by the end of 2010.

China CITIC-Prudential Life Insurance Company Limited

<u>Overview</u>

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 2009, CITIC-Prudential Life had business in 31 cities across China, including in the key markets of Guangdong, Beijing, Shanghai, Hubei, Shandong, Zhejiang, Jiangsu, Tianjin, Guangxi, Fujian and Hebei.

The body responsible for regulation of the insurance sector is the CIRC established in 1998. CIRC reports directly to the State Council. The main laws and regulations that govern the 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).

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

CIRC has focused specific attention on the area of risk prevention. Accordingly, it has identified five lines of defence against risks, namely internal management and control systems, supervision of solvency adequacy, on-site inspection, fund management regulation and insurance security fund. In 2008, in response to the global financial crisis, more importance has been attached to the supervision of internal control systems, corporate governance, marketing conduct and information disclosure of insurance companies. In addition to the introduction of additional regulations and rules, a classified supervision system was developed by the regulator to detect and monitor the operation and financial risks of the industry. Under the system, insurance companies will be classified into four groups based on the risk indicators relating to solvency margins, corporate governance, capital management, financial status and market conduct. Different administrative measures such as risk warning, on-site inspection, restriction of business expansion and investment, may be imposed on different groups.

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

Capital requirements

The minimum registered paid-up capital of a foreign invested insurance company is RMB200 million. A similar requirement is imposed on a Chinese branch of a foreign insurance company. Both foreign invested insurance companies and Chinese branches of foreign insurance companies are required to maintain a solvency ratio that is not lower than 100 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.

Reserve requirements

The CIRC has promulgated various rules and regulations on the reserves to be established and maintained by insurers, and the reserve requirements pursuant to such rules and regulations depend on the nature and type of insurance product. Reserves that the CIRC generally requires a life insurer to maintain include an unearned premium reserve, a life insurance reserve, a long-term health insurance reserve and an insurance -claims payment reserve. The reserve amounts are generally determined with reference to, among other things, actuarial projections of future cash flows.

Statutory and other deposit requirements

A foreign invested insurance company is required to deposit 20 per cent of its registered capital and a foreign insurer's Chinese branch is required to deposit 20 per cent of its working capital with a bank designated by the CIRC. This statutory deposit may only be used to discharge debts owed by an insurer in the event that it is put into liquidation or declared bankrupt.

A life insurer is required by the CIRC to contribute up to 1 per cent of its total assets to an insurance protection fund, which is a non-governmental fund maintained by a state-owned fund management company. In the event any insurer is put into liquidation or declared bankrupt or deemed by the CIRC to pose material risks to the public interest and financial stability, this insurance protection fund may be used, among other things, to pay policyholders or other life insurance companies accepting life policies assigned from the insolvent life insurer.

Separate accounts requirement

An insurer is required to maintain assets in separate accounts for certain types of products specified by the CIRC, including participating, universal life and investment-linked products. Establishment, amalgamation, demerger and closure of investment accounts maintained in respect of investment-linked products are subject to the approval of the CIRC.

Asset management

An insurer is required to invest its insurance funds in a stable and prudent manner. An insurer may only invest its insurance funds in bank deposits, securities, including, without limitation bonds, stocks and securities, investment fund shares, real estate and other permitted investments as stipulated by the China State Council. The CIRC also sets caps on the proportion of an insurer's total investments that can be held in particular classes of assets. Such caps may be revised by the CIRC from time to time. The approvals of the CIRC and State Administration of Foreign Exchange are required if the insurer wishes to invest insurance funds denominated in foreign currencies offshore.

Reinsurance

An insurer may reinsure its liabilities within its authorized scope as stated in its insurance business permit and business licence. An insurer is required to implement a comprehensive risk management system and report to the CIRC annually regarding its reinsurance arrangements. An insurer may only cede its liabilities to reinsurers who satisfy the CIRC's credit rating requirements (as specified from time to time) or are Chinese state-owned reinsurers.

Regulation of products

Products which are legally mandatory, newly developed life insurance or may concern the public interest are required to be reviewed and approved by the CIRC before they can be introduced to the market for sale.

Financial reporting requirements

The CIRC requires each insurer to file with the CIRC monthly financial accounts, annual audited financial statements and annual audited solvency statements prepared in accordance with applicable Chinese laws, rules and regulations.

Thailand Prudential Life Assurance (Thailand) Public Company Limited

Overview

Prudential Life Assurance (Thailand) Public Company Limited is authorized to carry on long-term insurance business in Thailand.

In Thailand, the insurance business is regulated and supervised by the Office of Insurance Commission ("OIC"). The OIC came about as a result of the September 2007 statutory transformation of the Department of Insurance of the Ministry of Commerce. The OIC is now the independent regulatory organization handling day-to-day insurance business affairs and reporting to the Ministry of Finance. The Secretary General of the Insurance Commission holds the statutory appointment of Insurance Registrar. Each quarter, insurers must contribute a proportion of their insurance premia to the OIC to cover the

OIC's operational expenses. The current rate for life insurers is between 0.1 per cent and 0.3 per cent (depending on the type of policy, its duration and payment terms) and the current rate for non-life insurers is between 0.2 per cent and 0.3 per cent (depending on the amount of insurance premia received).

The Insurance Commission Act 2007 embodies the Insurance Commission, the principal decision-maker for the insurance business. The Insurance Commission consists of a 13-member Board, chaired by the Permanent Secretary of Finance and includes the Permanent Secretary of Commerce, the Secretary General of the Consumer Protection Board, the Governor of the Bank of Thailand and the Secretary General of the Securities and Exchange Commission as *ex officio* commissioners. The other six to eight Commissioners are selected from experts in the fields of law, accountancy, business administration, finance, economics and insurance.

The life 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 impose a variety of statutory requirements. The OIC has the power to manage and supervise insurance companies, protect insured persons and the general public, implement policies with respect to insurance funds, and regulate the professional conduct, qualifications and licensing of insurance brokers, agents and actuaries.

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

Capital requirements

A branch office of a life foreign insurer must maintain assets in Thailand of not less than the amount of the capital funds required pursuant to relevant Thai regulations. In addition, life insurers are required to maintain capital funds at the greater of 2 per cent of their insurance reserve and 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.

Reserve and asset management requirements

The OIC requires a life insurance company to allocate a portion of its premium income to an insurance reserve for policies that remain in force. The insurance reserve may consist of a mixture of different classes of assets. The assets in the insurance reserve must match the insurer's liabilities as they come due over the duration of its policies. The types of assets that a life insurance company must place in its insurance reserve and the rules, conditions and basis for assessing the value of assets placed in the insurance reserve are regulated by the OIC.

Thai regulations require every life insurer to place a security deposit with the OIC of not less than 20 million Thai Baht, which may consist of a mix of cash and certain types of bonds, treasury bills and similar specified instruments. Every life insurer is also required to place 25 per cent of its insurance reserves with the OIC.

Under the Life Insurance Act of Thailand and relevant bankruptcy laws of Thailand, in the event that an insurer goes bankrupt, policyholders entitled to receive payment under their insurance policies have preferential rights to the assets placed with the OIC and have the right to receive payment from such assets as secured creditors. The amount which a policyholder may receive from the assets placed with the OIC and statutory fund is capped as 1 million Baht. Policyholders would also have preferential rights over the other assets of the insurer and the right to receive payment from such assets subject to the rights of secured creditors and certain other classes of preferred creditors.

Statutory fund

Life insurance companies are required to contribute to a central life insurance fund intended to compensate policyholders in the event that an insurer is declared bankrupt or has its licence revoked. The OIC requires insurers to make payments twice a year into this central life insurance fund. The current amount payable is 0.1 per cent of the premium income received in the six months prior to the payment date.

Reinsurance

When a life insurer wishes to cede its insurance liability under a policy by entering into a reinsurance treaty, it may only reinsure in respect of the net amount at risk that is outstanding on the policy as of each anniversary of the policy during its term.

A copy of every reinsurance treaty that an insurer enters into must be submitted to the OIC within 30 days of the date of its execution. Life insurers should also inform the OIC in the event a reinsurance treaty is amended or terminated and provide details of the same. The OIC may, if it deems it appropriate, request a life insurer to submit the reinsurer's annual report as to the reinsurer's financial and business condition in the previous year.

The OIC has proposed new reinsurance regulations which will require an insurer to adopt a formal reinsurance management strategy and submit it at regular intervals to the OIC for approval. The regulations will also prohibit an insurer from obtaining certain reinsurance without OIC approval, including finite risk reinsurance, financial reinsurance and other alternative risk transfer arrangements, and impose limitations on reinsurance that may be placed overseas based on the credit rating of the overseas reinsurers.

Regulation of products

Insurance policies, including their related documents and endorsements, must be in the form approved by the OIC. The use of non-approved policy documentation may result in policyholders having the option to terminate the policy with a full refund of premiums or to continue to benefit under the policy as written (or as amended by the order of the OIC). Marketing materials for an insurance policy are deemed to form part of the policy with any inconsistency between the marketing materials and policy to be construed in favor of the policyholder or beneficiary.

The premium rates for an insurance policy are also subject to the approval of the OIC. A notification issued by the OIC sets out the factors that it will take into account in determining premium rates.

The OIC prohibits all insurers from underwriting policies denominated in currencies other than Thai Baht but insurers may access reinsurance from overseas that is denominated in foreign currencies.

Life insurance policies are also affected by the eligibility criteria imposed by the Revenue Department of the Ministry of Finance on tax deductibility of premiums.

Regulation of agents and brokers

Insurance agents and brokers are licensed by the OIC. The OIC imposes caps on the commission rates that insurers may pay to insurance agents and brokers. The OIC prohibits insurers from paying commissions to other persons.

The OIC imposes general obligations on insurance agents and brokers in relation to their dealings with customers. It also imposes specific requirements on telephone sales, including restrictions on hours of operation, pre-vetting the types of policies that may be marketed, recording requirements and a 30-day cooling-off period, and on bancassurance.

Restrictions on foreign insurers

Expansion of the branch office network of a foreign insurer in Thailand is restricted pursuant to the Life Insurance Act of Thailand. Consequently, a foreign insurer currently may not open additional branch offices in Thailand.

Thai insurance companies generally must be at least 75 per cent Thai-owned. The Insurance Commission may allow up to 49 per cent foreign ownership and, where an insurer's condition or operation is likely to place policyholders or the public in jeopardy, the Minister of Finance may (on advice from the Insurance Commission) allow up to 100 per cent foreign ownership.

Restrictions on dividends and distributions

Although there are no formal limitations on dividends or other distributions by a Thai insurer or the Thai branch of a foreign insurer, the approval of the Bank of Thailand is required for remittances outside Thailand. In practice, the Bank of Thailand will typically consult with the OIC before permitting a Thai insurer or the Thai branch of a foreign insurer to make any remittances outside Thailand.

Financial reporting requirements

A life insurer is required to prepare and submit monthly and annual reports and interim quarterly and audited annual financial statements to the OIC in respect of both its branch offices and operations as a whole. A branch office of a foreign life insurance company must comply with the additional requirement of submitting an annual report of its parent company within five months of the end of the parent company's fiscal year. In addition, a certified actuarial report must be submitted annually by all insurers. An insurer is also required to post summary financial information on its website and at its head office and branch offices.

Philippines Pru Life Insurance Corporation of UK

Pru Life Insurance Corporation of UK is licensed and regulated by the Insurance Commission (the "IC") as a life insurance company.

The Insurance Code of the Philippines, as amended, ("Insurance Code") gives the power to supervise and regulate the operations and business of insurance companies to the IC. The IC is a government agency under the Department of Finance, and is headed by the Insurance Commissioner. The IC is a part of the Anti-Money Laundering Council together with the Bangko Sentral ng Pilipinas and the Securities and Exchange Commission ("SEC").

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

The IC issues 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 100,000.00 for any single claim. Decisions or orders of the IC may be appealed to the Court of Appeals. Moreover, informal and administrative complaints against malpractices by insurance companies or agents may also be filed with the IC. The IC is available to render assistance in settling any controversy between an insurance company and a policyholder relating to insurance.

India ICICI Prudential Life Insurance Company Limited

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.

In his Budget speech on February 26, 2010 the Finance Minister of India stated that a Financial Stability and Development Council will be set up, to strengthen and institutionalize the mechanism for maintaining financial stability without prejudice to the autonomy of regulators. It is proposed that this Council would monitor macro-prudential supervision of the economy, including the functioning of large financial conglomerates, and address inter-regulatory coordination issues. It will also focus on financial literacy and financial inclusion.

Indonesia PT. Prudential Life Assurance

PT. 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 Supervisory Board and Financial Institution of the Ministry of Finance. Previously, insurance companies in Indonesia were supervised by the Directorate of Insurance under the Directorate General of Financial Institutions of the Ministry of Finance (the "MoF"). In December 2005, the Government of Indonesia merged the Capital Market Supervisory Board and Directorate General of Financial Institutions under a single Capital Markets Supervisory Board and Financial Institution (the "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 issued decrees on business conduct, auditing, solvency, and the licensing of insurance companies. These decrees were supplemented by implementing regulations issued by the Bapepam LK.

The local Life Insurance Association (the "AAJI") continues to act as a conduit between insurers and the MoF and Bapepam LK in terms of the development of new regulations and guidelines.

The implementation of anti-money laundering controls in the insurance industry is monitored by the Indonesian Financial Transaction Reports and Analysis Center (the "PPATK"). The PPATK is an institution with the mission of preventing and eradicating money laundering in Indonesia. The Money Laundering Criminal Act Law (UU-TPPU) is the governing statute that establishes and empowers the PPATK as the key authority in the anti-money laundering regime in Indonesia.

Prudential's operations in Indonesia are authorized to distribute life insurance products with either conventional or Shariah principles. Whilst the regulations for life products with conventional principles are fully developed (in accordance to current market conditions), the government has promulgated new regulations in relation to life products with Shariah principles. In addition, to accommodate significant developments in the Indonesian insurance industry over the past few years, the government is taking proactive measures to revisit Law No. 2 of 1992 on Insurance Business. Meetings with various insurance associations have been conducted by the Government over the past year to obtain input from local as well as joint venture insurance companies. The amendment of Law No. 2 of 1992 on Insurance Business is expected to be promulgated in 2011.

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

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

On April 1, 2010, the Commercial Code of Japan was revised and the "insurance contract law" became a separate piece of legislation from the Commercial Code of Japan, now known as the "Insurance Act".

In response to the recent financial crisis, the JFSA revised the "solvency margin ratio", an indicator for regulatory purposes, to introduce stricter rules for the calculation of capital and risk measurements and to ensure its appropriateness by involving an appointed actuary. The new standard is to become effective for the fiscal year ending on March 31, 2012. However, reporting of the solvency margin ratio on the new basis will be required for the fiscal year ending on March 31, 2011 for monitoring purposes. The new solvency margin standard was officially issued on April 9, 2010.

On January 15, 2010, Prudential's Japanese insurance subsidiary announced the cessation of the underwriting of new policyholder contracts post 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. This cessation does not affect Prudential's asset management business in Japan, which is a separate entity from the insurance business with its own operating platform and distribution networks.

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 current insurance regulations were revised and a number of new regulations were introduced, including: minimum legal capital requirements for insurance enterprises, equivalent to VND 600 billion, security deposit requirements equivalent to 2 per cent of legal capital, new regulations for investment-linked products such as universal life and unit-linked products. The MOF has also provided specific regulations on establishing new insurance companies, modification of licenses or opening/closure of insurers' branches/representative offices and agent recruitment and training.

Generally, the Insurance Business Law and its guiding regulations focus mainly on administrative supervision of insurance operations. In practice, the Insurance Business Law reserves most of its items for insurance contracts (the terms and conditions of policy) in order to protect policyholders' interests. Furthermore, the MOF has set a proactive insurance supervisory agenda on controlling the solvency of insurance companies in order to take timely intervention to the insurance market by issuing the new regulation on bankruptcy procedures for insurers, securities, financial institutions in late 2008.

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.

Hong Kong

Overview

Certain types of products and services offered by Prudential in Hong Kong are regulated under separate statutory regimes by other regulatory bodies, including the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong) (the "MPFSO") , administered by the Mandatory Provident Fund Schemes Authority (the "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 (the "SFO") and other subsidiary legislation comprise the laws in Hong Kong relating to certain investment-linked products including MPF and ORSO retirement schemes, securities dealing, investment advisory and investment management services. The Hong Kong Securities and Futures Commission (the "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 ultimately a 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.

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 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.

Regulation under the MPFSO

Companies that operate compulsory retirement schemes in Hong Kong are regulated under the MPFSO. The MPFA shares responsibility with other regulatory bodies for supervision of the institutions, such as banks and insurance companies, that act as MPF intermediaries that provide MPF products to customers. The MPFSO includes rules on prudential management and the permissible investments that may be made using scheme funds, accounting and reporting requirements and the powers of the MPFA to intervene and terminate a trustee's administration of a scheme.

Regulation under the SFO

Companies that wish to conduct business in regulated activities (as stipulated in the SFO) which include, but are not limited to, Type 1 (Dealing in Securities), Type 4 (Advising on securities) and Type 9 (Asset Management) in Hong Kong must be licensed to do so under the SFO, and the marketing and promotion of certain financial products and schemes that involve investment in securities is also regulated under the SFO. Licensed corporations under the SFO are subject to certain requirements which include, but are not limited to; financial adequacy and reporting and directors, senior management and individuals responsible for carrying out the regulated activities in Hong Kong must satisfy suitability and qualification requirements and be approved by the HKSFC.

The operation, marketing and promotion of investment-linked products and schemes, including long-term insurance schemes by insurers, is subject to authorization by the SFC in accordance with Part IV of the SFO and related codes and guidelines issued by the SFC that require certain information to be disclosed to potential investors and impose restrictions on the content of advertisements and the claims that can be made with respect to risks and potential returns on an investment.

Japan

PCA Asset Management Limited ("PCAAM") is registered with the Kanto Local Finance Bureau to engage in (a) second financial instruments business, (b) investment management business, (c) investment advisory & agency business and (d) ancillary business under the Financial Instruments and Exchange Law ("FIEL") which became effective as of 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 the associations are self-regulatory bodies under FIEL. 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 the Financial Services Agency of Japan ("the JFSA").

Under its registration in respect of second financial instruments business, PCAAM focuses on explaining the products. PCAAM does not set up or maintain customer accounts for purposes of settlement, which are to be opened at relevant sales companies. The investment advisory & agency business is limited to the investment advisory business excluding agency business.

Korea

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

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. SROs support the regulatory and administrative operations entrusted to the SFB by adopting self-regulatory rules and overseeing self-regulation by its members, establishing a membership disciplinary framework and carrying out matters that the SFB has authorized it to handle, such as previewing product filing documents before submission for the SFB's final review. The SRO also acts as liaison between the SFB and its members for matters of business development.

China

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

The legislative framework of China's fund industry comprises the China Securities Investment Funds Law (the "Fund Law") and a set of ancillary regulations (the "Fund Regulations"). While the Fund Law and Fund Regulations spell out the rules and requirements which must be adhered to by all FMCs, the supervisory approach of CSRC, to a certain extent, is also principles-based. The Chinese authorities aim to protect the legitimate rights and interests of investors and other relevant parties, and thereby to promote the healthy development of securities investment funds and securities markets.

India

ICICI Prudential Asset Management Company Limited ("the AMC"), a joint venture between Prudential and ICICI 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 voting rights in the AMC or the right to appoint a majority of directors entitled to exercise control of the AMC will require the prior approval of the SEBI and the grant of an option to unit holders to exit the Schemes at the prevailing net asset value without any exit load.

As specified by the Indian Trusts Act 1882 and reiterated by the SEBI regulations, all mutual funds are required to be in the form of trusts. The trustee functions are carried out by separately established trust companies or boards of trustees. In all cases, the trust deed must be approved by the SEBI. The AMC has obtained registration from the SEBI to act as a Portfolio Manager under SEBI (Portfolio Managers) Regulations 1993.

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

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

Recent regulatory trends

SEBI has decided that all Mutual Funds shall have a systems audit conducted by an independent CISA/CISM qualified or equivalent auditor. Such an audit shall be conducted once every two years.

SEBI has provided a framework to facilitate transactions in Mutual Fund schemes through the Stock Exchange. For this purpose, Mutual Funds along with Registrar and Transfer Agents, Depositories and Depository Participants, shall take steps to facilitate the same.

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 Securities and Exchange Commission, US, under the Investment Advisers Act of 1940; the Financial Services Commission of South Korea, as a Cross-border Investment Advisor under the Capital Market Consolidation Act and the Securities and Exchange Board of India ("SEBI") under the SEBI (Foreign Institutional Investors) Regulations, 1995. Further, PAMS is relying on the Class Order Exemption CO 03/1102 from the Australian Securities and Investments Commission for exemption from the need to hold an Australian financial services 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).

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

Dubai

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

PAMD is regulated by the Dubai Financial Services Authority ("DFSA"), which is the independent regulator for DIFC. PAMD holds a 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.

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.

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.

Risk-based regulation

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

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

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' monitoring is supported by focused (relating to a firm or group) and themed (relating to the industry or market as a whole) visits where appropriate. In advance of discussions, the FSA request relevant mandatory management information at prescribed intervals, which helps to frame the agenda for these meetings.

Overview of FSMA 2000 regulatory regime

Single regulator

The FSA is currently the single regulator for all 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. 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.

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.

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 preapproved 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 entitlement to 10 per cent of more of the exercise of voting power of an authorized firm or its parent undertaking. When determining a person's level of control, that person's holding of shares or entitlement to exercise voting power will be aggregated with the holdings or entitlements of any person with whom he is "acting in concert". A person will be treated as increasing his control over an 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.

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 classify its clients according to their level of sophistication, provide them with information about the firm, meet certain standards of product disclosure, ensure that promotional material which it produces is clear, fair and not misleading, assess suitability when advising on certain products, manage conflicts of interest, report appropriately to its clients and provide certain protections in relation to client assets.

Treating Customers Fairly

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

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

Prudential supervision

As set out above, in order to maintain 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 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 Handbooks. However, once these procedures have been exhausted, qualifying complainants may turn to the Financial Ombudsman Service which is intended to provide speedy, informal and cost-effective dispute resolution of complaints made against 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 sub-schemes 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 sub-schemes so as to minimize cross-subsidy between authorized persons whose businesses are not similar. The recent defaults by a number of deposit-takers have led to a large payout by the FSCS, which have been funded mainly by loans from the Bank of England and HM Treasury to the FSCS. The interest costs on the loans will be funded out of the deposits sub-scheme alone. However, the repayment of the loans is likely to be funded to an extent by the 'general pool' with such payments commencing 2011/12. The "general pool" is in part funded by levies on the Insurance sub-scheme in which Prudential sits.

The FSA has committed to start a comprehensive review of the FSCS funding model and intends to consult with firms and other relevant industry bodies in 2010/2011.

Regulation of insurance business

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

Conduct of business requirements for insurance business

The Conduct of Business rules issued by the FSA apply differing requirements to the sale of general and long-term insurance contracts, as well as applying certain requirements to transactions in other designated investments. Authorized firms which advise and sell to private customers packaged products such as life insurance policies are subject to detailed conduct of business obligations relating to product disclosure, assessment of suitability, the range and scope of the advice which the firm provides, and fee and remuneration arrangements.

The FSA launched a Retail Distribution Review (the "RDR") in 2006 with the specific aim of improving the retail investment market. In June 2009 the FSA published a consultation paper containing proposals for implementing the RDR with proposals seeking to: (i) improve the clarity with which firms describe their services to consumers; (ii) address the potential for adviser remuneration to distort consumer outcomes; and (iii) increase the professional standards of advisers. Detailed proposals for enhancing the professionalism of investment advisers under the RDR were published by the FSA in December 2009 and a further consultation paper in this area is expected to be published in the third quarter of 2010. In relation to the first two elements of the RDR, on 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. The proposals are expected to take effect at the end of 2012.

Capital requirements for insurers

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

The FSA's rules now require an insurer to prepare and submit to the FSA its own assessment of its capital requirements, known as an individual capital assessment ("ICA"), based on the risks it faces. The FSA will use the ICA in order to form its own view of a firm's capital requirements. If the FSA considers that the firm does not hold adequate capital resources, it will issue individual capital guidance ("ICG") which it can impose as a requirement.

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

Under the rules in GENPRU, an insurer must hold capital resources equal at least to the Minimum Capital Requirement (the "MCR"). Insurers with with-profits liabilities of £500 million or more must hold capital equal to the higher of MCR and the Enhanced Capital Requirement (the "ECR"). The ECR is intended to provide a more risk responsive and "realistic" measure of a with-profits insurer's capital requirements, whereas the MCR is broadly speaking equivalent to the previously required minimum margin under the IPRU (INS) and satisfies the minimum EU standards.

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

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

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

Actuarial functions

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

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

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

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

Distribution of profits and with-profits business

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

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

The FSA confirmed in July 2009 that proprietary life insurance companies will not be able to meet future compensation and redress payments from their with-profits funds. Following two previous consultations, the FSA confirmed a rule change meaning that liabilities arising from operational failures (including mis-selling) after the rule came into effect from 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-profit business. The FSA has issued specific rules on this area in relation to with-profits policyholders, which address, among other things, the costs charged to a with-profits fund by the firm managing the fund; penalties and charges levied on policyholders who surrender their policies early, the need for funds to be managed with the objective of ensuring that maturity payouts fall within a target range set for the fund; and the provision of information to with-profits policyholders or potential policyholders in a format that they can more readily understand through the introduction of "Consumer Friendly Principles and Practices of Financial Management" ("CFPPFMs").

Reporting requirements

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

Transfer of insurance business

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

Winding-up rules

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

Additionally, in the United Kingdom, all FSA 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, and has applied to the Group from December 2007, following the sale of Egg Banking during 2007. Prior to this, the Group was required to meet the requirements of the Financial Conglomerates Directive ("FCD") as implemented in the FSA rules, as the Group was classified as an insurance conglomerate.

Prudential's move during 2007 from being treated as an insurance conglomerate to being treated as an insurance group under the FSA rules did not have a significant impact on the Group, as the FSA's prudential requirements pertaining to insurance groups are very similar to those applying to insurance conglomerates.

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 co-ordinating 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. These pillars are quantitive 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". At "Level 3" non-binding standards and guidance will be agreed between national supervisors and at "Level 4" the European Commission will monitor compliance by Member States and take enforcement action as necessary. Separately to Solvency II, proposed changes to the European supervisory architecture, which are yet to be finalized, are likely to mean that, in addition, binding technical standards will be produced at "Level 3".

The European Commission expects to legally adopt Level 2 implementing measures by the end of 2011. The planned implementation date for the new regime is October 31, 2012. However, the Commissioner for Internal Market and Services recently proposed that the implementation date should be moved to December 31, 2012.

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.

Capital requirements for investment businesses

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

Liquidity requirements for investment businesses

In October 2009 the FSA published its final rules on the liquidity requirements expected of BIPRU firms, which are designed to enhance firms' liquidity risk management practices. The qualitative aspects of the new rules, which affect the systems and controls that firms are required to have in place to deal with liquidity risk, came into force on 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 Commission has published a draft Alternative Investment Fund Managers Directive designed to regulate private equity and hedge funds. As currently drafted, the Directive may have significant consequences for funds which are not a "UCITS". This could, in turn, materially increase compliance and regulatory costs for certain funds.

The Directive is subject to consultation and potential revision and redrafting, so the final text remains uncertain and it is not expected to come into effect until 2011.

US Supervision of M&G Investment Management

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

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 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. Initial verbal feedback that were not any material findings but the final examination reports have not yet been issued by either the Michigan or New York authorities.

Jackson's ability to pay shareholder dividends is limited under Michigan insurance law. The Commissioner of the Michigan Office of Financial and Insurance Regulation (the "Michigan Insurance Commissioner") may limit, or not permit, the payment of shareholder dividends if the Michigan Insurance Commissioner determines that an insurer's surplus, as regards policyholders, is not reasonable in relation to its outstanding liabilities and is not adequate to meet its financial needs as required by Michigan insurance law. Jackson must report any shareholder dividends to the Michigan Insurance Commissioner before they can be paid. In the case of an extraordinary shareholder dividend or distribution, an insurer may not pay the dividend or distribution until 30 days after the Michigan Insurance Commissioner has received notice of the declaration and has not disapproved, or has approved, the payment within that period. For this purpose, an extraordinary dividend or distribution means any dividend or distribution of cash or other property where the fair market value, together with that of other dividends or distributions that an insurer made within the preceding twelve months, exceeds the greater of 10 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 2007, 2008 and 2009, Jackson paid shareholder dividends of US$246.0 million, US$313.10 million, and US$250.0 million, respectively.

State regulators also require prior notice or regulatory approval of changes in control of an insurer or its holding company and of certain material transactions with affiliates. Under New York and Michigan insurance laws and regulations, no person, corporation or other entity may acquire control of an insurance company or a controlling interest in any parent company of an insurance company, unless that person, corporation or entity has obtained the prior approval of the regulator. For the purpose of each of New York and Michigan law, any person acquiring, directly or indirectly, 10 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 in an acquisition does not have the effect of changing or influencing control.

Guaranty associations and similar arrangements

Each of the 50 states of the United States, the District of Columbia and the Commonwealth of Puerto Rico has laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. These associations and arrangements provide certain levels of protection to policyholders from losses under insurance policies issued by insurance companies that become impaired or insolvent. Typically, these associations levy assessments, up to prescribed limits, on member insurers on a basis that is related to the member insurer's proportionate share of the business in the relevant jurisdiction of all member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Some jurisdictions permit member insurers to recover assessments that they paid through full or partial premium tax offsets, usually over a period of years. The Prudential Group estimated its reserve for future guarantee fund assessments for Jackson to be £18.1 million (US$26.0 million) at December 31, 2008. Prudential estimated its reserve for future guarantee fund assessments for Jackson to be £15.4 million (US$24.9 million) as December 31, 2009. The Prudential Group believes this reserve to be adequate for all anticipated payments for known insolvencies.

Asset valuation reserve

State regulators generally require that insurers establish an asset valuation reserve that consists of two components: a "default component" to provide for future credit-related losses on fixed income investments and an "equity component" to provide for losses on all types of equity investments. The asset valuation reserve establishes statutory reserves for fixed maturity securities, equity securities, mortgage loans, real estate and other invested assets. The reserve is designed to provide for a 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 slower growth in surplus or a reduction in Jackson's unassigned surplus, which, in turn, may reduce funds available for shareholder distributions. The extent of the impact of the asset valuation reserve on Jackson's statutory surplus depends in part on the future composition of the investment portfolio.

Interest maintenance reserve

State regulators generally require that insurers establish an interest maintenance reserve to defer non-credit-related realized capital gains and losses, net of taxes, on fixed income investments (primarily bonds and mortgage loans) which are amortized into net income over the estimated remaining periods to maturity of the investments sold 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, all of Jackson's ratios fell within the usual range. In 2008, Jackson had one ratio fall outside the usual range for which there were no regulatory consequences.

Policy and contract reserve sufficiency analysis

State insurance laws require life insurance companies to conduct annually an analysis of the sufficiency of its life and annuity reserves. A qualified actuary must submit an opinion that states that the reserves, when considered in the light of the assets that an insurance company holds with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurance company. If a qualified actuary cannot provide such an opinion, then the insurance company must set up additional reserves by moving funds from surplus. The 2009 opinion has been submitted to the Michigan Office of Financial and Insurance Regulation without any qualifications.

Jackson's capital and surplus

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

As a licensed insurer in the District of Columbia and every state but New York, where it operates through a subsidiary, Jackson is subject to the supervision of the regulators of each jurisdiction. In connection with the continual licensing of Jackson, regulators have discretionary authority to limit or prohibit the new issuance of business to policyholders when, in their 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 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, 2009 and expires October 1, 2010, unless extended by the Michigan Insurance Commissioner. The effects of this permitted practice may not be considered by the company when determining the surplus available for dividends, nor the nature of dividends as ordinary or extraordinary.

Risk-based capital

The National Association of Insurance Commissioners has developed risk-based capital standards for life insurance companies as well as a model act for state legislatures to enact. The model act requires that life insurance companies report on a formula-based, risk-based capital standard that they calculate by applying factors to various asset, premium and reserve items. The formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk and business risk. The National Association of Insurance Commissioners designed the formula as an early warning tool to identify potentially inadequately 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, 2009, due in part to the permitted practice noted in "Jackson's Capital and Surplus" above, the Company's total adjusted capital under the National Association of Insurance Commissioners' definition substantially exceeded Michigan standards.

Regulation of investments

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

USA Patriot Act

The USA Patriot Act, enacted in 2001, includes numerous provisions designed to fight international money laundering and to block terrorist access to the US financial system. The US Treasury Department has issued a number of regulations implementing the Patriot Act that apply certain of its requirements to financial institutions including broker dealers and insurance companies. Among other things, the regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. Jackson and, to the extent applicable, certain of its affiliates, has established policies and procedures to ensure compliance with the Patriot Act's provisions and the Treasury Department regulations.

Securities laws

Jackson, certain of its affiliates and certain policies and contracts that Jackson issues are subject to regulation under the federal securities laws administered by the US Securities and Exchange Commission ("the SEC").

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

Jackson National Asset Management, LLC ("JNAM") is registered with the SEC as an investment adviser pursuant to the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act"). JNAM is registered as a transfer agent pursuant to the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"). The investment companies (mutual funds) for which JNAM serves as an investment adviser are subject to SEC registration and regulation pursuant to the Securities Act of 1933, as amended (the "Securities Act"), and the Investment Company Act of 1940, as amended (the "Investment Company Act"). In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product are 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.

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

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

Although no assurances can be given, Jackson believes that none of its contracts is of the type to which the holding in Harris Trust would be applicable. Moreover, the Department of Labor has issued PTE 95-60, which generally exempts external, unaffiliated investment transactions from ERISA's prohibited transaction provisions. If the Harris Trust holding is applied to its contracts, Jackson would be subject to ERISA's fiduciary and prohibited transaction provisions described above.

Financial services regulatory and legislative issues

Proposals to change the laws and regulations governing the financial services industry are frequently introduced in the US Congress, in the state legislatures and before the various regulatory agencies. The likelihood and timing of any proposals or legislation, and the impact they might have on Jackson, its subsidiaries, or other Prudential subsidiaries doing business in the US, cannot be determined at this time.

State legislatures and/or state insurance regulatory authorities frequently enact laws and/or regulations that significantly affect insurers supervised by such authorities. Although the US federal government does not directly regulate the insurance business, federal initiatives may also have an impact on the insurance industry.

The US Congress has been actively attempting to address financial reform. The Senate and House have passed their versions of reform legislation and a conference committee has been appointed to reconcile the two bills. The conference committee began meeting on June 10, 2010 and is expected to hold several public sessions with a goal of concluding its work by June 25, 2010. To meet the Administration and Congressional Democrats' goal of sending a bill to the President before the 4th of July, Chairman of the House Financial Services Committee's schedule anticipates House passage of a conference report by June 29, 2010, leaving the Senate several days to act upon the conference report.

Among the key differences to be resolved during the conference are the House and Senate approaches to the jurisdiction and powers of a consumer financial protection entity, the scope of derivatives regulations, potential restrictions on interchange fees, and whether to establish the "Volcker Rule" prohibition on proprietary trading by banks.

Many Democrats support the Obama Administration's proposal for an independent Consumer Financial Protection Agency, but several Republicans strongly oppose this idea and have suggested housing a new consumer protection entity within the Federal Reserve or the Federal Deposit Insurance Corporation. The Senate Banking Committee Chairman's tentative embrace of housing this entity within the Federal Reserve met with particularly sharp criticism from several Senate Banking Committee Democrats. These Senators, along with the House Financial Services Committee Chairman, objected to giving additional consumer responsibility to the Federal Reserve.

The US President has in the past proposed to increase the taxes levied against the insurance industry to increase the federal budget revenues. In February 2009, President Obama proposed a 2.9 per cent tax on so-called unearned income from certain investments, including annuities. The industry has been very successful in resisting these proposals on the grounds that an increase in taxes on insurance companies or insurance policies would have a negative affect on US citizens saving for their retirement. The insurance industry is very vigilant in monitoring these proposals and taking action to oppose them, as well as to support proposals that would provide more favorable tax treatment for certain annuity products.

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 been formed that is opposed to the so-called optional federal charter. Prudential cannot predict whether any federal charter or any other federal (or state) legislative initiative to change the nature or scope of the regulation of the insurance industry will be enacted into law.

Federal and state regulators have focused on the mutual fund and variable annuity and insurance product industries including the broker-dealer system. As a result of publicity relating to widespread perceptions of industry abuses, including fraudulent and anti-competitive practices among insurance brokers and mutual funds, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms. It is difficult to predict at this time whether changes resulting from industry investigations and/or new laws and regulations will affect the Group's insurance or investment management businesses, and, if so, to what degree.

Federal regulators have determined that fixed indexed annuities, previously regulated by the states, should instead be regulated at the federal level. In early 2009, the SEC issued a release adopting a new rule (151A) that will bring fixed-indexed annuities under the jurisdiction of the federal regulatory system. This rule will apply prospectively to annuities that are issued on or after January 12, 2011. Subsequent to adoption, Rule 151A became the subject of litigation. In late 2009, the US Court of Appeals for the D.C. Circuit ordered the litigants (the SEC and Old Mutual US, et al) to submit briefs on the appropriate remedy for the SEC's failure to consider the rule's effect on efficiency and competition when promulgating the rule. Old Mutual argued that the rule should be vacated or stayed. The SEC disagreed but offered a two-year stay of the rule. In early 2010, the court directed Old Mutual to file an additional brief addressing the SEC's proposal to defer the effective date of Rule 151A for 2 years if and from the time the rule is reissued. Practically speaking, the SEC's offer to stay the rule, if implemented, will likely move the effective date of the rule from January 12, 2011 to mid-2012 or late 2012. The court is currently considering the supplemental briefs. Jackson is well positioned to operate under this change of regulatory structure.

Item 4A. Unresolved staff comments

None

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's aim is to promote the financial well-being of its customers and their families, with a particular focus on saving for retirement and security in retirement.

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 leading Prudential strategy, cash and capital management, leadership development and succession, reputation management and other core group functions.

Prudential Corporation Asia is the leading European-based life insurer in Asia in terms of market coverage and the number of top five market positions. Prudential has life insurance and asset management operations in 13 markets covering China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand, Vietnam and the United Arab Emirates. On January 6, 2010 Prudential announced it had entered into an agreement to acquire from United Overseas Bank Limited ("UOB") its 100 per cent interest in UOB Life Assurance in Singapore for a total cash consideration of SGD428 million (approximately £192 million), subject to a post-completion adjustment to reflect the net asset value as at the completion date. This acquisition accompanied the announcement of a long-term strategic partnership with UOB. Through this partnership Prudential's life insurance products will be distributed through UOB Group's 414 bank branches across Singapore, Indonesia and Thailand. Furthermore, on January 15, 2010 Prudential's Japanese insurance subsidiary announced its intention to cease writing new policyholder contracts in Japan after February 15, 2010. The company reinforced its commitment to servicing its existing policyholder base, which comprised over 170,000 contracts as at September 30, 2009. This decision will be reviewed on an on-going basis in light of changes to the business environment. On March, 1, 2010, Prudential announced the proposed combination of Prudential and the AIA Group. However, subsequently, on June 2, 2010, Prudential confirmed that its agreement with AIG for this proposed combination had been terminated. See note I11 to the consolidated financial statements in Item 18 for further details.

Jackson provides retirement savings and income solutions in the mass and mass-affluent segments of the US market, primarily to retirees and those nearing retirement.

Prudential UK insurance operations is a leading provider of retirement savings and income solutions and life assurance in the UK and believes it has a strong combination of competitive advantages, including its significant longevity experience, multi-asset management capabilities and its brand and financial strength. Prudential UK provides a range of financial products and services, including annuities, corporate pensions, with-profits and unit-linked bonds, savings and investment products, protection and health insurance products.

M&G is Prudential's UK and European fund management business and has £174 billion of assets under management as at December 31, 2009, of which £104 billion relates to Prudential's long-term business funds. M&G aims to maximize profitable growth by operating in markets where it has leading positions and competitive advantages, including the markets for retail fund management, institutional fixed income, pooled life and pension funds, property and private finance.

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.

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

After the severe difficulties encountered by the world economy and financial markets in the second half of 2008, Prudential entered 2009 with a deliberately defensive position. Prudential recognized early on the implications of the new economic climate and focused its strategy on capital conservation and cash generation. Prudential prioritized value over volume and allocated capital strictly to the products and channels with the highest rates of return and shortest payback periods. This led Prudential to reduce significantly its volumes of wholesale business, allowing it to grow the relatively more profitable retail sales by 11 per cent in a year when many companies saw a contraction or stagnation of sales. This disciplined approach meant that, as conditions started to improve, Prudential's capital strength allowed it to capture a more than proportionate share of many of its target markets.

Through Prudential's international, selective and disciplined approach it maintains a diverse portfolio of businesses, which embraces countries at different stages of economic development, but which all share one key attribute: the opportunity for Prudential to build a market-leading operation with prospects for sustainable, long-term, profitable growth and a superior rate of return on capital.

Prudential's financial strength is fundamental to its strategy and as a result of its disciplined risk management approach and targeted group-wide actions to grow and protect its capital, Prudential is emerging from the global economic downturn with greater strength demonstrated by its increased IGD capital. Prudential believes that this capital strength has been instrumental in Prudential's ability to invest in profitable growth in 2009, especially in its chosen markets in Asia and the US.

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

Asia

Asia is home to 60 per cent of the world's population and, given its impressive economic transformation over the last few years, the region now has an increasingly significant role in the global economy. This is translating into the rapid emergence of an increasingly urbanized and wealthy mass affluent sector that generates outstanding growth potential in retail financial services as people look to protect their financial well-being and manage their savings in more sophisticated and efficient ways. In addition, Asia's growing and increasingly middle class population face a growing need for financial advice and products to help people save for retirement, secure an income during retirement and protect their financial well-being throughout life.

The word 'Asia' is used extensively and broadly to describe what is, in fact, a highly diverse region of the world. This diversity exhibits itself in a myriad of ways: culture, religion, politics, wealth and distribution of wealth and not least, language. Furthermore, within the financial services sector there are complex legal and regulatory environments which vary materially by country. These are important considerations for any business with aspirations to develop businesses in Asia. While there are undoubtedly commonalities and opportunities for synergy across the region, a 'one size fits all' approach will generally produce suboptimal results. Prudential's own diversity in terms of geographic presence, distribution channels and products continues to be a key factor in the success of its life insurance and asset management businesses.

The concept that Asian economies are decoupling from Western economies is a point for continued debate, but external indicators suggest that Asia is recovering more quickly from the recent global financial crisis. Sound fundamentals coupled with aggressive stimuli have enabled most Asian economies to outperform the developed Western markets over the course of 2009. So long as inflation remains under control, Prudential expects that the Asian central banks are likely to resist currency appreciation and maintain low interest rates. Prudential also anticipates that capital flows into Asia should increase as Asia's GDP growth continues to outpace the rest of the world.

In Asia, Prudential continued to benefit in 2009 from its focus on regular premium products, as sales of single premium products suffered amid the market dislocation experienced in the first half of the year. In addition, the breadth of offering enabled Prudential to refocus its energies on higher-margin health and protection products, and also on with-profits for the more cautious investor.

Overall, Prudential believes that its strategy, and the consistency with which it executes it, are the core factors that differentiate it from its peers.

US

The United States is the world's largest retirement savings market, and is continuing to grow rapidly. As 78 million baby boomers[1] reach retirement age, their retirement assets will shift from asset accumulation to income distribution. There are already US$2 trillion of assets generating retirement income in the US and this amount is forecast to rise to some US$7 trillion by 2029[2].

(1) Source: US Census Bureau

(2) Source: Tiburon Strategic Advisers, LLC

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

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

Prudential's US business, Jackson, benefited significantly from this flight to quality in the US annuity market. Jackson's strategy continues to target increasing volumes in variable annuities in line with the goal of capital preservation. As Jackson focused on optimizing the balance between new business profits and capital consumption, no institutional sales were made during the full year of 2009.

Jackson was predominantly a spread-based business until recently, with the majority of its assets invested in fixed income securities. Recently its fee-based business has become more prominent and now represents a significant part of Jackson's business mix.

In general, Jackson's results are heavily affected by fluctuations in economic and market conditions, especially interest rates, credit conditions and equity markets. The profitability of Jackson's spread-based business depends in large part on its ability to manage interest rate spreads, as well as the credit and other risks inherent in its investment portfolio. Jackson designs its US products and manages the investments supporting this business to reduce interest rate sensitivity. This has the effect of moderating the impact on 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.

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.

UK

In 2009, Prudential UK performed strongly against a challenging background of difficult capital markets, volatile equity markets and widespread economic uncertainty which led to consumers looking for greater certainty and security through trusted and financially strong brands. Prudential UK believes that the business has a good combination of competitive advantages including its longevity experience, multi-asset investment capabilities, strong brand and financial strength. These helped put Prudential UK in a robust position to generate attractive returns across its businesses.

The UK is characterized by an ageing population and the concentration of wealth in the mass affluent and high net worth sectors, a combination that positions the retirement and near-retirement segment as the fastest growing in the marketplace. Low savings rates and high levels of consumer debt, coupled with an increasing shift in responsibility for providing retirement income away from Government and employers towards individuals, have resulted in individuals in the UK being inadequately provided for during increasingly long periods of retirement.

Prudential UK has a significant pipeline of internal vestings into its annuity business from maturing individual and corporate pension policies, which is expected to remain strong at least over the next ten years. Management have based this assessment on a combination of analysis of the projected value of maturities of in-force business (after allowing for lapses) used within Prudential's actuarial valuation models as at December 31, 2008 and analysis of the Selected Retirement Date contained with the policy data for a population covering approximately 75 per cent of in-force pension business. Prudential UK is one of the largest annuity providers in the UK market, with approximately 1.5 million annuities in payment as at December 31, 2009. Looking ahead, the UK annuities market is expected to grow in the near-term, and Prudential UK believes it is well positioned to maintain a significant share of this market.

In the United Kingdom, where Prudential's with-profits fund invests in debt and other fixed income securities, equity securities and real estate, shareholders' profits under IFRS are strongly related to the bonuses it declares. The most important influences on the bonus rates are the overall rate of return earned on investments and Prudential's expectation of future investment returns. Further information on with-profits products is provided in 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.

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.

Additional regulation, scrutiny and related costs have put pressure on the margins on new business. In the United States, Jackson has been the subject of class action litigation which are discussed in more detail in 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, result 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, 2009, there were no unendorsed standards effective for the three years ended December 31, 2009 affecting the consolidated financial information of Prudential or the parent company financial information, and there was no difference between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the three years ended December 31, 2009 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 in so far 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 respect of Prudential's with-profits business except for the treatment of the unallocated surplus. This distinction reflects the basis of recognition of profits and the 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 affect the reported fair value of these financial investments.

The financial investments measured at fair value are classified (from January 1, 2009) into the following three level hierarchy on the basis of the lowest level of inputs that is significant to the fair value measurement of the financial investments concerned:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2: Inputs other than quoted prices included within level 1 that are observable either directly or indirectly (i.e. derived from prices).

Level 3: Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As at December 31, 2009, £5,557 million of the financial investments (net of derivative liabilities) valued at fair value were classified as level 3, which represents three per cent of the total financial investments (net of derivative liabilities) carried at fair value at that date. Of these, £1,684 million are held to back shareholder non-linked business, and so changes to these valuations will directly affect shareholders' equity. Further details of the classification of financial instruments are given in note G1 to the consolidated financial statements in Item 18.

Determining impairments relating to financial assets

Available-for-sale securities

1. Information regarding the 2009 and 2008 results

Under IAS 39, Prudential has the option on purchase to account for individual financial instruments as available-for-sale. Currently, the only financial investments carried on an available-for-sale basis by Prudential 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 for maturity helps to inform whether assessments of estimated future cash flows that are higher than market value are reasonable.

- The duration and extent to which the 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, principal or interest payment shortfall. If a shortfall applies an impairment charge is recorded.

The difference between the fair value and book cost for unimpaired securities accounted for as available-for-sale falls to be accounted for as 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 information, unrealized losses currently in equity may be recognized in the income statement in future periods. The preceding note in this section provides explanation on how fair value is determined when the markets for the financial investments are not active. Further additional details on the impairments of the available-for-sale securities of Jackson are described in notes D3 and G5 of the consolidated financial statements in Item 18.

Impairment losses recognized on available-for-sale securities amounted to £630 million (2008: £497 million; 2007: £35 million). Of this amount, 86 per cent (2008: 29 per cent; 2007: 14 per cent) has been recorded on structured asset-backed securities, primarily due to reduced cash flow expectations on such securities that are collateralized by diversified pools of primarily below investment grade securities. Of the losses related to the impairment of fixed maturity securities the top five individual corporate issuers made up 11 per cent (2008: 27 per cent; 2007: 57 per cent) reflecting a deteriorating business outlook of the companies concerned. The impairment issues have been recorded in "investment return" in the income statement.

In 2009, Prudential realized gross losses on sales of available-for-sale securities of £134 million (2008: £184 million; 2007: £86 million) and with 60 per cent (2008: 55 per cent; 2007: 46 per cent), and of these losses related to the disposal of fixed maturity securities of five (2008 and 2007: six) individual issuers, which were disposed of to rebalance the portfolio in the US operations in response to the unstable mortgage lending.

The effect of those reasonably likely changes in the key assumptions underlying the estimates that underpin the assessment of whether impairment has taken place depends on the factors described above. A key indicator of whether such impairment may arise in future, and the potential amounts at risk, is the profile of gross unrealized losses for fixed maturity securities accounted for on an available-for-sale basis by reference to the time periods by which the securities have been held continuously in an unrealized loss position and by reference to the maturity date of the securities concerned.

The unrealized losses in the US insurance operations statement of financial position on unimpaired securities are £966 million (2008: £3,178 million). This reflects assets with fair market value of £7,254 million (2008: £17,422 million) and a book value of £8,220 million (2008: £20,600 million).

(a) Fair value of securities as a percentage of book value

The following table shows the fair value of the debt securities in a gross unrealized loss position for various percentages of book value as at December 31, 2009 and 2008. Book value represents cost/amortized cost of the debt securities.

Fair value of securities as a percentage of book value	2009 Fair value	2009 Unrealized loss	2008 Fair value	2008 Unrealized loss
	(£ million)			
Between 90 per cent and 100 per cent	**5,127**	**(169)**	8,757	(431)
Between 80 per cent and 90 per cent	**1,201**	**(203)**	4,581	(809)
Below 80 per cent	**926**	**(594)**	4,084	(1,938)
Total	**7,254**	**(966)**	17,422	(3,178)

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	2009 Fair value	2009 Unrealized loss	2008 Fair value	2008 Unrealized loss
	(£ million)			
Between 90 per cent and 100 per cent	**102**	**(3)**	479	(27)
Between 80 per cent and 90 per cent	**160**	**(28)**	120	(19)
Below 80 per cent	**159**	**(88)**	192	(166)
Total	**421**	**(119)**	791	(212)

Sub-prime and Alt-A securities with unrealized losses of £21 million (2008: £91 million) in the statement of financial position at December 31, 2009 and 2008 respectively, have been in an unrealized loss position for less than one year with the remaining securities with unrealized losses of £98 million (2008: £121 million) being in an unrealized loss position for more than one year.

(b) Unrealized losses by maturity of security

	2009 Unrealized loss	2008 Unrealized loss
	(£ million)	
Less than 1 year		(21)
1 to 5 years	**(29)**	(537)
5 to ten years	**(127)**	(1,236)
More than ten years	**(92)**	(395)
Mortgage-backed and other debt securities	**(718)**	(989)
Total	**(966)**	(3,178)

(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	2009 Non-investment grade	2009 Investment grade	2009 Total	2008 Non-investment grade	2008 Investment grade	2008 Total
			(£ million)			
Less than 6 months	**(7)**	**(51)**	**(58)**	(108)	(362)	(470)
6 months to 1 year	**(25)**	**(59)**	**(84)**	(125)	(1,164)	(1,289)
1 year to 2 years	**(59)**	**(234)**	**(293)**	(154)	(622)	(776)
2 years to 3 years	**(125)**	**(199)**	**(324)**	(15)	(91)	(106)
More than 3 years	**(35)**	**(172)**	**(207)**	(61)	(476)	(537)
Total	**(251)**	**(715)**	**(966)**	(463)	(2,715)	(3,178)

(d) Securities whose fair value was below 80 per cent of the book value

As shown in the table (a) above, £594 million (2008: £1,938 million), of the £966 million (2008: £3,178 million) of gross unrealized losses at December 31 2009, related to securities whose fair value was below 80 per cent of the book value. The analysis of the £594 million (2008: £1,938 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	2009 Fair value	2009 Unrealized Loss	2008 Fair value	2008 Unrealized Loss
	(£ million)			
Residential mortgage-backed securities				
Prime	**322**	**(153)**	287	(115)
Alt-A	**77**	**(33)**	144	(127)
Sub-prime	**82**	**(55)**	48	(39)
	481	**(241)**	479	(281)
Commercial mortgage-backed securities	**87**	**(86)**	811	(375)
Other asset-backed securities	**183**	**(188)**	198	(86)
Total structured securities	**751**	**(515)**	1,488	(742)
Corporates	**175**	**(79)**	2,596	(1,196)
Total	**926**	**(594)**	4,084	(1,938)

Age analysis of fair value being below 80 per cent for the period indicated:

Age analysis	2009 Fair value	2009 Unrealized loss	2008 Fair value	2008 Unrealized loss
	(£ million)			
Less than 3 months	**153**	**(45)**	3,118	(1,364)
3 months to 6 months	**5**	**(3)**	696	(403)
More than 6 months	**768**	**(546)**	270	(171)
Total	**926**	**(594)**	4,084	(1,938)

2. Information regarding the position as at March 31, 2010

On May 17, 2010, Prudential published its first quarter 2010 Interim Management Statement with the UK Listing Authority. This statement included details on the financial position as at March 31, 2010 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 shareholders' equity.

Jackson continues to review its investments on a case-by-case basis to determine whether any decline in fair value (other-than-temporary market value movements) represents an impairment and therefore requiring an accounting write-down. IFRS requires available-for-sale debt securities which are impaired to be written down to fair value through the profit and loss account.

The defaults, losses on sales of impaired and deteriorating bonds (net of recoveries) and write-downs for the three months to March 31, 2010 were as follows:

	Defaults	Bond write downs (£ million)	Losses on sales of impaired and deteriorating bonds (net of recoveries)
Corporate debt securities			18
Residential mortgage backed securities			
Prime		5	33
Alt-A		14	19
Sub-prime		7	
Other		9	6
		35	76

Debt securities in an unrealized loss position

For Jackson's securities classified as available-for-sale under IAS 39, at March 31, 2010 there was a net unrealized loss position of £438 million. This amount comprised £1,142 million of gross unrealized gains and £704 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 profit and loss in full. The table above shows the element of write downs in 2010. Included within the gross unrealized losses is £454 million for securities which are valued at less than 80 per cent of book value, of which 14 per cent have been at this level for less than 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.

(a)

Movements in the values for the three months to March 31, 2010:

Movements in the values of available-for-sale securities for the three months to March 31, 2010 are included in the table shown below:

		Changes reflected directly in shareholders' equity			
	March 31, 2010	Movement in Quarter 1	Foreign exchange translation*	Quarter 1 including foreign exchange	December 31, 2009
			(£ million)		
Assets fair valued at below book value					
Book value	**7,589**	(1,131)	500	(631)	8,220
Unrealized loss	**(704)**	316	(54)	262	(966)
Fair value (as included in balance sheet)	**6,885**	(815)	446	(369)	7,254
Assets fair valued at or above book value					
Book value	**17,218**	1,791	983	2,774	14,444
Unrealized gain	**1,142**	106	66	172	970
Fair value (as included in balance sheet)	**18,360**	1,897	1,049	2,946	15,414
Total					
Book value	**24,807**	660	1,483	2,143	22,664
Net unrealized (loss) gain	**438**	422	12	434	4
Fair value (as included in balance sheet)*	**25,245**	1,082	1,495	2,577	22,668

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*

Balance sheet items for Jackson National Life have been translated at the closing rate for the period, being $1.5169 at March 31, 2010. Jackson National Life income statement movements have been translated at the average exchange rate for the period, being $1.43 for three months to March 31, 2010.

(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, 2010 were £704 million (December 31, 2009: £966 million) relating to assets with fair market value and book value of £6,885 million (December 31, 2009: £7,254 million) and £7,589 million (December 31, 2009: £8,220 million) respectively.

The following table shows the fair value of the securities in a gross unrealized loss position for various percentages of book value:

	Fair value March 31, 2010	Unrealized loss March 31, 2010	Fair value December 31, 2009	Unrealized loss December 31, 2009
		(£ million)		
Between 90 per cent and 100 per cent	**5,501**	**(130)**	5,127	(169)
Between 80 per cent and 90 per cent	**678**	**(120)**	1,201	(203)
Below 80 per cent	**706**	**(454)**	926	(594)
	6,885	**(704)**	7,254	(966)

(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:

	Fair value March 31, 2010	Unrealized loss March 31, 2010	Fair value December 31, 2009	Unrealized loss December 31, 2009
	(£ million)			
Between 90 per cent and 100 per cent	**67**	**(3)**	102	(3)
Between 80 per cent and 90 per cent	**32**	**(6)**	160	(28)
Below 80 per cent	**124**	**(61)**	159	(88)
	223	**(70)**	421	(119)

(c) Securities whose fair value were below 80 per cent of the book value

As shown in the table above, £454 million (December 31, 2009: £594 million) of the £704 million (December 31, 2009: £966 million) gross unrealized losses at March 31, 2010 related to securities whose fair value were below 80 per cent of the book value. The age analysis for this £454 million (December 31, 2009: £594 million), indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

	Fair value March 31, 2010	Unrealized loss March 31, 2010	Fair value December 31, 2009	Unrealized loss December 31, 2009
	(£ million)			
Less than 3 months	**66**	**(19)**	153	(45)
3 months to 6 months	**33**	**(11)**	5	(3)
More than 6 months	**607**	**(424)**	768	(546)
	706	**(454)**	926	(594)

For securities valued at less than 80 per cent of book value, 70 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:

	Fair value March 31, 2010	Unrealized loss March 31, 2010	Fair value December 31, 2009	Unrealized loss December 31, 2009
	(£ million)			
RMBS				
Prime	**247**	**(115)**	322	(153)
Alt-A	**38**	**(17)**	77	(33)
Sub-prime	**86**	**(44)**	82	(55)
	371	**(176)**	481	(241)
Commercial mortgage backed securities	**47**	**(63)**	87	(86)
Other asset backed securities	**178**	**(172)**	183	(188)

Total structured securities	**596**	**(411)**	751	(515)
Corporates	**110**	**(43)**	175	(79)
	706	**(454)**	926	(594)

Assets held at amortized cost

Financial assets classified as loans and receivables under IAS 39 are initially recognized at fair value plus transaction costs. Subsequently they are carried at amortized cost using the effective interest rate method. 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

(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 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(f)(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 other with-profits contracts applicable to Prudential's activities in 2009 and 2008, 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 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. Prior to its disposal of the Taiwan agency business in the first half of 2009, Prudential's financial results were also sensitive to the assumed future investment returns for that business.

Jackson

Jackson offers individual fixed annuities, fixed index annuities, immediate annuities, variable annuities, individual and variable life insurance and institutional products. With the exception of institutional products and an incidental amount of business for annuity certain contracts, which are accounted for as investment contracts under IAS 39, all of Jackson's contracts are accounted for under IFRS 4 as insurance contracts by applying US GAAP, the previous GAAP used before IFRS adoption. Under US GAAP the requirements of FAS 60 'Accounting and Reporting for Insurance Enterprises' and FAS 97 'Accounting and Reporting by Insurance Enterprises for certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments' apply to these contracts. The accounting requirements under these standards and the effect of changes in valuation assumptions are considered below for fixed annuity, variable annuity and traditional life insurance contracts.

Fixed annuity contracts, which are investment contracts under US GAAP terminology, are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts, namely deferred income, any amounts previously assessed against policyholders that are refundable on termination of the contract, and any premium deficiency, i.e. any probable future loss on the contract. These types of contract contain considerable interest rate guarantee features.

Notwithstanding the accompanying market risk exposure, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of Jackson's fixed annuity products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement.

Variable annuity contracts written by Jackson may provide for guaranteed minimum death, income, or withdrawal benefit features. In general terms, liabilities for these benefits are accounted for under US GAAP by using estimates of future benefits and fees under best estimate assumptions.

For variable annuity business, the key assumption is the expected long-term level of equity market returns, which for all years included was 8.4 per cent per annum (gross of fund management fees) determined using a mean reversion methodology. Under the mean reversion methodology, projected returns over the next five years are flexed (subject to capping) so that, combined with the actual rates of return for the current and the previous two years the 8.4 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(h) 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.

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.

Prior to its disposal in the first half of 2009, the principal non-participating business in Prudential's Asian operations, for which changes in estimates and assumptions were important from year to year, was the traditional whole-life business written in Taiwan. Premium rates were set to give a guaranteed minimum sum assured on death and a guaranteed surrender value on early surrender based on prevailing interest rates at the time of policy issue. Premium rates also included an allowance for mortality and expenses. This business was therefore especially sensitive to falling interest rates. This exposure has been removed following the disposal of the Taiwan agency business. The remaining non-participating business in Asia remains sensitive to interest rates but this sensitivity is of a much lower order. Further details are provided in note D4(i) to the consolidated financial 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 operations is for individual and group annuity business where the incidence of acquisition costs is negligible.

Jackson

For term business, acquisition costs are deferred and 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(h) and H1 to the consolidated financial statements in Item 18.

Asian operations

In 2008, a number of changes have been made to the basis of estimating the level of deferred acquisition costs, as described in note D4(h)(c) to the consolidated financial statements in Item 18.

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 information reflects the higher of any underlying IAS 19 deficit and any obligation for deficit funding.

The economic participation in the surplus or deficits attaching to PSPS and the smaller Scottish Amicable Pensions Scheme ("SAPS") are shared between the PAC with-profits sub-fund ("WPSF") and shareholder operations. The economic interest reflects the source of contributions over the scheme life, which in turn reflects the activity of the members during their employment.

In the case of PSPS, movements in the apportionment of the financial position for PSPS between the WPSF and shareholders' funds in 2009 reflect the 70/30 ratio applied to the base deficit position as at 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 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 directly 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 and changes in mortality assumptions and changes in inflation assumptions.

The table below shows the sensitivity of the underlying PSPS, Scottish Amicable and M&G pension scheme liabilities as at December 31, 2009 of £4,436 million, £515 million and £223 million respectively to changes in discount rates and inflation rates.

		2009	
Assumption	**Change in assumption**	**Impact on scheme liabilities on IAS 19 basis**	
Discount rate	Decrease by 0.2% from 5.8% to 5.6%	Increase in scheme liabilities by:	
		PSPS	3.5%
		Scottish Amicable	5.2%
		M&G	4.9%
Discount rate	Increase by 0.2% from 5.8% to 6.0%	Decrease in scheme liabilities by:	
		PSPS	3.2%
		Scottish Amicable	4.8%
		M&G	4.9%
Rate of inflation	Decrease by 0.2% from 3.7% to 3.5% with consequent reduction in salary increases	Decrease in scheme liabilities by:	
		PSPS	0.9%
		Scottish Amicable	4.9%
		M&G	4.5%

The sensitivity of the underlying pension scheme liabilities to changes in discount rates and inflation rates as shown above does not directly equate to an impact on the profit or loss attributable to shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund. Further information is included in note I2 of the consolidated financial information in Item 18.

For PSPS, the underlying surplus of the scheme of £513 million (2008: £728 million), as at December 31, 2009 and 2008, 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.

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.

This applies similarly to the Scottish Amicable scheme, whose deficit has been allocated 50 per cent to the PAC with-profits fund and 50 per cent to the PAC shareholders fund.

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 regime applicable to Prudential applies 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 information 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 IFRS 4, assets and liabilities of these contracts (see below) are accounted for under previously applied GAAP. In limited circumstances the Group has chosen to apply a more relevant or reliable measure. The following paragraphs explain how Prudential currently applies this Policy. Except as described below, in respect of UK regulated with-profits funds where the basis applied has been improved to a more relevant or reliable measure (also as permitted under IFRS 4), the modified statutory basis ("MSB") of reporting as set out in the revised Statement of Recommended Practice ("SORP") issued by the Association of British Insurers ("ABI") has been applied to Prudential's UK and overseas operations.

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 Prudential's current overseas operations, the application of the MSB (which permits the use of local GAAP in some circumstances) varies depending upon the basis of accounting applied prior to IFRS adoption or acquisition by Prudential, and whether adjustments to the basis or a more appropriate method should be applied. For Jackson, applying the MSB as applicable to overseas operations, which permits the application of local GAAP in some circumstances, the assets and liabilities of insurance contracts are accounted for under insurance accounting prescribed by US GAAP. For the assets and liabilities of insurance contracts of Prudential's current Asian operations, the local GAAP is applied with adjustments, where necessary, to comply with UK GAAP. For the operations in Taiwan, Vietnam and Japan, countries where local GAAP is not appropriate in the context of the previously applied MSB, accounting for insurance contracts is based on US GAAP. For participating business the liabilities include provisions for the policyholders' interest in 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(f)(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. With the exception of value movements on derivatives held for variable annuities and other equity hedging activities, the value movements on derivatives held by Jackson are separately identified within the short-term fluctuations in investment returns identified as part of Prudential's segment results described below and in note B1 to the consolidated financial statements in Item 18. Derivative value movements in respect of equity risk within variable annuity business and other equity related hedging activities are included within the operating profit based on longer-term investment returns.

For derivative instruments of Jackson, 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
- 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 assets classified as loans and receivables, all financial investments and investment property are designated as assets at fair value through profit and loss. Short-term fluctuations in investment returns on such assets held by with-profits funds, do not affect directly reported shareholder results. This is because (i) the unallocated surplus of with-profits funds is accounted for as 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.

	Year Ended December 31,		
	2009	2008	2007
	(£ million)		
Total revenue, net of reinsurance	**48,099**	(10,267)	32,870
Total charges, net of reinsurance	**(46,535)**	8,193	(31,812)
Profit (loss) before tax *(being tax attributable to shareholders' and policyholders' returns)**	**1,564**	(2,074)	1,058
Tax attributable to policyholders' returns	**(818)**	1,624	5
Profit (loss) before tax attributable to shareholders	**746**	(450)	1,063
Tax (expense)/credit	**(873)**	1,683	(349)
Less: tax attributable to policyholders' returns	**818**	(1,624)	(5)
Tax attributable to shareholders' (losses) profits	**(55)**	59	(354)
Profit (loss) from continuing operations after tax	**691**	(391)	709
Discontinued operations (net of tax)	**(14)**		241
Profit (loss) for the year	**677**	(391)	950

* 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 period, 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 the UK shareholders and the UK financial market. Separately, in this section, analysis of movements in profits before shareholder tax is provided by nature of revenue and charges.

Explanation of Movements in Profits After Tax and Profits Before Shareholder Tax by Reference to the Basis Applied for Segmental Disclosure

(a) Group overview

The £677 million profit for the year after tax for 2009 compared to a £391 million loss for 2008. This £1,068 million increase reflects 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 reflects 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 7 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 reflects 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.

Loss for 2008 was £391 million compared with a profit of £950 million in 2007. This £1,341 million decrease reflects a movement from a profit from continuing operations after tax of £709 million in 2007 to a loss from continuing operations of £391 million in 2008 and a profit from discontinued operations of £241 million in 2007.

The movement from a profit to a loss from continuing operations after tax reflects a movement from a profit to a loss before tax attributable to shareholders of £1,513 million, from a profit of £1,063 million in 2007 to a loss of £450 million in 2008, partially offset by a £413 million decrease in the tax attributable to shareholders, which fell from a charge of £354 million in 2007 to a credit of £59 million in 2008. The effective tax rate in 2008 was 13 per cent compared with 33 per cent in 2007. Further details are provided in note F5 to the consolidated financial statements in Item 18.

The movement from a profit before tax attributable to shareholders on continuing operations to a loss in 2008 reflects an increase in operating profit based on longer-term investment returns on continuing operations of £146 million, from £1,201 million in 2007 to £1,347 million in 2008, which was more than offset primarily by a £1,646 million negative movement in short-term fluctuations in investment returns taken to income, which increased from a charge of £137 million in 2007 to a charge of £1,783 million in 2008.

In 2007, Prudential's discontinued operations related to the UK banking business following the sale of Egg Banking Plc on May 1, 2007. The 2009 charge reflected completion adjustments for a previously disposed business.

(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).

The following table shows Prudential's IFRS consolidated total profit/(loss) for the years indicated presented by summary business segment and geographic region. The accounting policies applied to the segments below are the same as those used in the Group's consolidated accounts.

	Year Ended December 31, 2009				
	Asia	US	UK	Unallocated corporate	Total
			(£ million)		
Insurance operations	**(218)***	588	489		859
Asset management**	**42**	3	219		264
Total profit attributable to the segments	**(176)**	591	708		1,123
Unallocated corporate				(432)	(432)
Discontinued operations***				(14)	(14)
Total profit (loss) for the year	**(176)**	591	708	(446)	677

	Year Ended December 31, 2008				
	Asia	US	UK	Unallocated corporate	Total
			(£ million)		
Insurance operations	19	(580)	320		(241)
Asset management	39	1	55		95
Total profit attributable to the segments	58	(579)	375		(146)
Unallocated corporate				(245)	(245)
Total (loss) profit for the year	58	(579)	375	(245)	(391)

	Year Ended December 31, 2007				
	Asia	US	UK	Unallocated corporate	Total
			(£ million)		
Insurance operations	55	300	310		665
Asset management	72	9	162		243
Total profit attributable to the segments	127	309	472		908
Unallocated corporate				(199)	(199)
Discontinued operations***				241	241
Total profit (loss) for the period	127	309	472	42	950

*

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.

***

Additional information on discontinued operations is set out in note I9 to the consolidated financial statements in Item 18.

Profit from insurance operations

Total profit from insurance operations in 2009 was £859 million compared to a loss of £241 million in 2008 and a profit of £665 million in 2007. All of the profits from insurance operations in 2009, 2008 and 2007 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 discontinued operation under IFRS. The movement in profits for insurance operations can be summarized as follows:

	Year Ended December 31,		
	2009	2008	2007
	(£ million)		
Profit before shareholder tax	**1,025**	(183)	1,010
Shareholder tax	**(166)**	(58)	(345)
Profit (loss) after tax	**859**	(241)	665

The significant 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 £559 million loss relating to the sale of the Taiwan agency business. The loss arising on the sale of the Taiwan agency business is explained further in the comparison of total loss arising from Asian insurance operations below.

The significant decrease of £1,193 million in profit before tax attributable to shareholders in 2008 compared to 2007 primarily reflects negative short-term fluctuations in investment returns, offset by an increase in operating profit based on longer-term investment returns of the insurance operations

The effective shareholder tax rate on profits from insurance operations decreased from 32 per cent in 2008 to 16 per cent in 2009. This was due to a number of factors including:

- In Asia, profits in certain countries being not taxable partly offset by the inability to fully recognize deferred tax assets on losses carried forward;

- In the US, the ability to fully recognize deferred tax assets on losses brought forward which were previously unable to be recognized together with income subject to a lower level of taxation and the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business;

- In the UK, adjustments in respect of the prior year tax charge and different tax bases of UK life business.

The movement on effective shareholder tax rate on profits from insurance operations from 34 per cent in 2007 to 32 per cent in 2008 was as a result of a number of factors including:

- In Asia, tax losses which are not expected to be available against future profits and losses on investments in jurisdictions which do not provide corresponding tax relief;

- In the US, the inability to fully recognize deferred tax assets on losses being carried forward; and

- In the UK, prior year adjustments arising from routine revisions of tax returns, the settlement of outstanding issues with HM Revenue and Customs and the different tax bases for UK life business partially offset by the inability to recognize a deferred tax asset on various tax losses.

In order to understand how Prudential's results are derived it is necessary to understand how profit emerges from its business. This varies from region to region, primarily due to differences in the nature of the products and regulatory environments in which Prudential operates.

Asia

Basis of profits

The assets and liabilities of contracts classified as insurance under IFRS 4 are determined in accordance with methods prescribed by local GAAP and adjusted to comply, where necessary, with UK GAAP. Under IFRS 4, subject to the conditions of that standard, the continued application of UK GAAP in this respect is permitted.

For Asian operations in countries where local GAAP is not well established and in which the business is primarily non-participating and linked business, US GAAP is used as the most appropriate reporting basis. This basis is applied in Japan and Vietnam, and materially for 2008 and 2007, but less for 2009 following the sale of the agency business, in Taiwan. For with-profits business in Hong Kong, Singapore and Malaysia, the basis of profit recognition is bonus driven as described 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 (loss)/profit arising from Asian insurance operations for 2009, 2008 and 2007:

	Year Ended December 31,		
	2009	**2008**	**2007**
	(£ million)		
(Loss)/profit before shareholder tax	**(180)**	92	103
Shareholder tax	**(38)**	(73)	(48)
(Loss)/profit after tax	**(218)**	19	55

The increase of £272 million in the loss before tax attributable to shareholders in 2008 to £180 million in 2009 primarily reflects the losses relating to the sale (as described below) and the trading results of the Taiwan agency business, partially offset by a favorable 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.

On the sale of the agency distribution business in Taiwan, a loss of £559 million was recorded. The overall size of the loss reflects the carrying value of the IFRS equity of the business as applied in the calculation of the loss on sale and the application of 'grandfathered' US GAAP under IFRS 4 for insurance assets and liabilities. US GAAP does not, and is not designed to, include the cost of holding economic capital to support the legacy interest rate guaranteed products as recognized under the Company's supplementary reporting basis under European Embedded Value principles. The IFRS loss on sale reflects this missing element of the economic value. Under IFRS there is no recognition of the enhanced Insurance Group's Directive ('IGD') capital surplus position arising on completion of the sale of £0.8 billion.

Included in the loss on sale are associated fees and restructuring costs of £64 million, the most significant component of which is costs associated with the termination of employees. The loss on sale also includes a charge of £44 million for write off of goodwill attached to the business.

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. The reason for this is as of January 1, 2009, the local regulatory basis has been replaced by the Malaysian authority's risk-based capital (RBC) framework. In the light of this development, the Company has re-measured the liabilities by reference to the method applied under the new RBC framework, which is more realistic than the previous approach, but with an overlay constraint to the method such that negative reserves derived at an individual policyholder level are not included.

The effective shareholder tax rate changed from 79 per cent in 2008 to 21 per cent in 2009. This was due to profits in certain countries being not taxable partly offset by the inability to fully recognize deferred tax assets on losses carried forward.

The £11 million decrease in profit before tax attributable to shareholders in 2008 arose primarily from a decrease in short-term fluctuations in investment returns included in the IFRS income statement of £153 million, which fell from a profit of £15 million in 2007 to a loss of £138 million in 2008. This was offset by an increase in operating profit based on longer-term investment returns of £106 million from £125 million in 2007 to £231 million in 2008.

The effective shareholder tax rate increased from 47 per cent in 2007 to 79 per cent in 2008. This increase was due to tax losses in several jurisdictions which are not expected to be available against future profits, and losses on investments in jurisdictions which do not provide corresponding tax relief.

United States

Basis of profits

The profit on Jackson's business predominantly arises from spread income from interest-sensitive products, such as fixed annuities, institutional products and fee income on variable annuities, which are measured on a US GAAP basis.

Comparison of total profit (loss) arising from US insurance operations

The following table shows the movement in profits arising from US insurance operations for 2009, 2008 and 2007:

	Year Ended December 31,		
	2009	2008	2007
	(£ million)		
Profit (loss) before shareholder tax	**486**	(652)	426
Shareholder tax	**102**	72	(126)
Profit (loss) after tax	**588**	(580)	300

Of the £1,138 million increase in profit before tax attributable to shareholders for 2009 compared to 2008, the main driver was a favorable change of £1,085 million in the short-term value movements in financial instruments reflected in the income statement, and an increase of £53 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. These increases were offset by the combined negative accounting impact of equity market movements on Jackson's variable annuity business and related hedging program. The hedging program is undertaken on an economic basis and the accounting measurement does not always fully capture the economic effects.

The effective tax rate on profit/(loss) from US operations increased from 11 per cent in 2008 to a credit 21 per cent in 2009. The movement was caused by the ability to fully recognize deferred tax assets on losses brought forward which were previously unable to be recognized together with income subject to a lower level of taxation and the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business.

The £1,078 million decrease in 2008 of profit before tax attributable to shareholders reflects the change in short-term fluctuations in investment returns of £1,040 million, from a loss of £18 million in 2007 to a loss of £1,058 million in 2008 and a decrease in operating profit based on longer-term investment returns of £38 million, from £444 million in 2007 to £406 million in 2008.

The effective tax rate on profits from US operations decreased from a charge of 30 per cent in 2007 to a credit of 11 per cent in 2008. The movement was caused by the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business.

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, 2009, liabilities to with-profits policyholders were in aggregate of £55.6 billion. Liabilities to with-profits policyholders in Asia as at December 31, 2009 were £8.8 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.

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

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 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.

	2009	2008	2007
		(£ million)	
Net income of the fund:			
Investment return	**10,461**	(14,595)	5,881
Claims incurred	**(6,253)**	(7,068)	(6,512)
Movement in policyholder liabilities	**(3,692)**	13,504	(2,307)
Add back policyholder bonuses for the year (as shown below)	**1,827**	2,565	2,522
Claims incurred and movement in policyholder liabilities (including charge for provision for asset shares and excluding policyholder bonuses)	**(8,118)**	9,001	(6,297)
Earned premiums, net of reinsurance	**3,063**	2,927	4,181
Other income	**(2)**	(36)	1,417
Acquisition costs and other operating expenditure	**(842)**	(408)	(2,105)
Tax (charge) credit	**(640)**	1,191	(24)
Net income of the fund before movement in unallocated surplus	**3,922**	(1,920)	3,053
Movement in unallocated surplus	**(1,893)**	4,769	(252)
Surplus for distribution	**2,029**	2,849	2,801
Surplus for distribution allocated as follows:			
90 per cent policyholders bonus (as shown above)	**1,827**	2,565	2,522
10 per cent shareholders' transfers	**202**	284	279
Total	**2,029**	2,849	2,801

Unallocated surplus

The unallocated surplus represents the excess of assets over policyholder liabilities of Prudential's with-profits funds. The annual excess or shortfall of income over expenditure of the with-profits funds after declaration and attribution of the cost of bonuses to policyholders and shareholders is transferred to, or from, the unallocated surplus through a charge or credit to the income statement. The balance retained in the unallocated surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance of the unallocated surplus is determined after full provision for deferred tax on 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.

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.

Comparison of total profit arising from UK insurance operations

Profit after tax from UK insurance operations increased by £169 million from £320 million in 2008 to £489 million in 2009:

The following table shows the movement in profits arising from UK insurance operations for 2009, 2008 and 2007:

	Year Ended December 31,		
	2009	2008	2007
	(£ million)		
Profit before shareholder tax	**719**	377	481
Shareholder tax	**(230)**	(57)	(171)
Profit after tax	**489**	320	310

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 favorable 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 schemes of £46 million (2008: nil). 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 increment returns in 2009 included general insurance commission of £51 million (2008: £44 million).

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 adjustments in respect of the prior year tax charge and different tax bases of the UK life business.

The decrease in 2008 in profit before tax attributable to shareholders of £104 million primarily reflects an increase in short-term fluctuations in investment returns charged to income of £165 million from a £47 million charge in 2007 to a £212 million charge in 2008, partially offset by growth in operating profit based on longer-term investment returns of £61 million from £528 million in 2007 to £589 million in 2008. Profit before tax in 2008 included general insurance commission of £44 million (2008: £4 million).

The effective shareholder tax rate on profits from UK insurance operations decreased from 36 per cent in 2007 to 15 per cent in 2008. The decrease mainly related to prior year adjustments arising from routine revisions of tax returns, the settlement of outstanding issues with HM Revenue and Customs at an amount previously provided and the different tax bases of UK life business.

Profit from asset management

Total profit from asset management increased from £140 million in 2008 to £353 million in 2009. The following table shows the movement in profits from asset management for 2009, 2008 and 2007:

	Year Ended December 31,		
	2009	2008	2007
	(£ million)		
Profit before shareholder tax	**353**	140	344
Shareholder tax	**(89)**	(45)	(101)
Profit after tax	**264**	95	243

The £213 million increase in 2009 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 £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 favorable 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.

The £204 million decrease in profit before tax attributable to shareholders in 2008 resulted primarily from a decrease in profit generated by M&G, which decreased from a profit before tax of £263 million in 2007 to a profit before tax of £81 million in 2008. The Group's profit before shareholder tax for the Asian asset management operations decreased by £20 million and for the US broker-dealer operations decreased by £2 million from 2007 to 2008.

The £182 million decrease in profit before tax attributable to M&G reflected unfavorable movements of £199 million in respect of short-term fluctuations in investment returns, which were partially offset by an increase in operating profit based on longer-term investment returns of £32 million. Actuarial losses on its defined benefit scheme increased by £15 million.

The effective tax rate on profits from asset management operations increased from 29 per cent in 2007 to 32 per cent in 2008. The increase in effective rate reflects the inability to use losses incurred in 2008, offsetting lower tax rates in Asia and on certain income in the UK.

Unallocated corporate result

Total net of tax charges for unallocated corporate activity increased by £187 million from £245 million in 2008 to £432 million in 2009 and by £46 million from £199 million in 2007 to £245 million in 2008.

The following table shows the movement in the unallocated corporate result for 2009, 2008 and 2007:

	Year Ended December 31,		
	2009	**2008**	**2007**
	(£ million)		
Loss before shareholder tax	**(632)**	(407)	(291)
Shareholder tax	**200**	162	92
Loss after tax	**(432)**	(245)	(199)

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 temporarily put in place during the first quarter to protect the Group's IGD capital surplus in the light of exceptional market conditions. During the severe equity market conditions experienced in the first quarter of 2009 coupled with historically high equity volatility, the 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 have expired and have not been renewed. The total unallocated corporate result for 2009 included a one-off £235 million cost arising from the hedge.

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 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 now recognize 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.

The movement in loss before shareholder tax in 2008 primarily resulted from a negative movement of £112 million in short-term fluctuations in investment returns, from a loss of £6 million in 2007 to a loss of £118 million in 2008, and an adverse change of £5 million in actuarial gains and losses on the Group's defined benefit pension schemes in 2008 in comparison to 2007.

The effective tax rate on the unallocated corporate result increased from 32 per cent in 2007 to 40 per cent in 2008. This was due to the settlement of issues with the HMRC at amounts below those previously provided and a reduction in amounts previously provided on outstanding issues with HMRC which was partially offset by the inability to recognize a deferred tax asset on various tax losses.

(c) Additional explanation of performance measures and analysis of consolidated results by business segment and geographical region

The Group 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.

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). Segment results that are reported to the Group Executive Committee ('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. This is consistent with how the Group has been presenting its results in its supplementary analysis of profit before tax attributable to shareholders.

Longer-term investment returns included within the performance measure are determined by reference to expected long-term rates of return. These are intended to reflect historical rates of return on assets and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The overriding reason for distinguishing longer-term investment returns from short-term fluctuations is that the investments are generally held for the longer-term to back long duration insurance contract liabilities and solvency capital rather than for short-term trading purposes.

Furthermore, the income statement recognition of investment appreciation, short-term value movements on derivatives, and the charge for the policyholder benefits under IFRS 4 give rise to accounting mismatches that are not representative of the underlying economic position.

Additional details on the determination of operating profit based on longer-term investment returns are provided below.

Determining operating segments and performance measure of operating segments

Prudential determines and presents operating segments based on the information that internally is 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 Prudential's organizational structure, which is by both geography (Asia, US, UK) and by product line (insurance operations versus asset management). Prudential's operating segments as determined under IFRS 8 are:

Insurance operations

Asia

US (Jackson)

UK

Asset management operations

M&G

Asian asset management

US broker dealer and asset management (including Curian).

Prudential Capital has been incorporated into the M&G operating segment for the purposes of segment reporting.

The performance measure of operating segments utilized by Prudential is 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 2009 this measure excludes the non-recurrent cost of hedging Prudential IGD capital surplus included within short-term fluctuations in investment returns. In 2009, Prudential sold its Taiwan agency business. In order to facilitate comparisons on a like-for-like basis, the loss on sale and the results of the Taiwan agency business during the period of ownership (including those for the 2008 and 2007 comparatives) are shown separately within the segmental analysis of profit. Segment results that are reported to the GEC include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and Asia Regional Head Office.

For the purposes of measuring operating profit 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.

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. The RMR charge for Jackson is based on long-term average default and recovery data as published by Moody's. During 2009 refinements were made to the RMR process following the National Association of Insurance Commissioners ("NAIC") issuing risk-based capital valuation data for more than 20,000 RMBS securities.

Longer-term equity returns comprise aggregate long-term income and capital returns.

Derivative value movements

Value movements for Jackson's equity-based derivatives and variable annuity product embedded derivatives are included in operating profit based on longer-term investment returns. The inclusion of these movements is so as to broadly match with the results on the Jackson variable annuity book that pertain to equity market movements, (subject to some limitations for GMDB products where US GAAP insurance accounting does not fully reflect the economic features being hedged). These accounting mismatches are magnified in a period of significant market movements.

Other derivative value movements are excluded from operating results based on longer-term investment returns. These derivatives are primarily held by Jackson as part of a broadly based hedging program for features of Jackson's bond portfolio (for which value movements are booked directly to shareholders' equity rather than income statement) and product liabilities (for which US GAAP accounting does not reflect the economic features being hedged).

These key elements are of most importance in determining the operating results based on longer-term investment returns of Jackson.

There are two exceptions to the basis described above for determining operating results based on longer-term investment returns. These are for:

- Unit-linked and US variable annuity separate account business.

For such business, the policyholder liabilities are directly reflective of the asset value movements. Accordingly, all asset value movements are recorded in the operating results based on longer-term investment returns.

- Assets covering non-participating business liabilities that are interest rate sensitive.

For UK annuity business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the "operating results based on longer-term investment returns". Policyholder liabilities include a margin for credit as explained in note D2(f)(iii) of the consolidated financial statements in Item 18. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

Liabilities to policyholders and embedded derivatives for product guarantees

Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between territories depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities are broadly equivalent in the income statement, and operating profit based on longer-term investment returns is not distorted. In these circumstances there is no need for the movement in the liability to be bifurcated between the element that relates to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (i.e. after allocated investment returns and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

Asia

Vietnamese participating business

For the participating business in Vietnam, the liabilities include policyholders' interest in investment appreciation and other surplus. Bonuses paid in a reporting period and accrued policyholder interest in investment appreciation and other surpluses primarily reflect the level of 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 segmental analysis of profit before tax attributable to policyholders.

Non-participating business

Liabilities are bifurcated so that the movement in the carrying value of liabilities is split between that which is included in operating results based on longer-term investment returns, and the residual element for the effect of using year-end rates is included in short-term fluctuations and in the income statements.

Guaranteed Minimum Death Benefit product features

For unhedged Guaranteed Minimum Death Benefit ("GMDB") liabilities accounted for under IFRS using 'grandfathered' US GAAP, such as in the Japanese business, the change in carrying value is determined under FASB Accounting Standards Codification Subtopic 944-80 (formerly SOP 03-1), which partially reflects changes in market conditions. Under Prudential's supplementary 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.

US operations embedded derivatives for variable annuity guarantee features

Under IFRS, the Guaranteed Minimum Withdrawal Benefit ("GMWB") and Guaranteed Minimum Income Benefit ("GMIB") reinsurance are required to be fair valued as embedded derivatives. The movements in carrying values are affected by changes in the level of observed implied equity volatility and changes to the discount rate applied from year to year. For these embedded derivatives, as described in note D3(i) to Prudential's consolidated financial statements in Item 18, the discount rate applied reflects AA corporate bond curve rates. For the purposes of determining operating profit based on longer-term investment returns, the charge for these features is determined using historical longer-term equity volatility levels and long-term average AA corporate bond rate curves.

UK shareholder-backed annuity business

With one exception, the operating result based on longer-term investment returns reflects the impact of all value movements on policyholder liabilities for annuity business in PRIL and the PAC non-profit sub-fund.

The exception is for the impact on credit risk provisioning of actual downgrades during the year. As this feature arises due to short-term market conditions the effect of downgrades, if any, in a particular period, on the overall provisions for credit risks is included in the category of short-term fluctuations in investment returns.

The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest applied to portfolio rebalancing to align more closely with the management benchmark.

Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply. For these businesses, it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include 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 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 records 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.

Reconciliation of total 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 loss before tax (including tax attributable to policyholders' returns) to loss before tax attributable to shareholders and loss for the period is shown below.

	2009	2008	2007
		(£ million)	
Insurance business			
Long-term business(ii)			
Asia	**416**	257	140
US(iv)	**459**	406	444
UK	**606**	545	524
Development expenses	**(6)**	(26)	(15)
Long-term business profit	**1,475**	1,182	1,093
UK general insurance commission(v)	**51**	44	4
Asset management business			
M&G	**238**	286	254
Asia asset management	**55**	52	72
Curian	**(6)**	(3)	(5)
US broker-dealer and asset management(iv)	**10**	10	13
	1,823	1,571	1,431
Other income and expenditure(viii)	**(395)**	(260)	(260)
Restructuring costs(ix)	**(23)**	(28)	(19)
Total IFRS operating profit based on longer-term investment returns(i)	**1,405**	1,283	1,152
Short-term fluctuations in investment returns(vi)			
Insurance operations	**166**	(1,408)	(50)
IGD hedge costs	**(235)**		
Other operations	**105**	(313)	(1)
Total short-term fluctuations in investment returns	**36**	(1,721)	(51)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes(vii)	**(74)**	(13)	(1)
Profit/(loss) before loss on sale and results of Taiwan agency business	**1,367**	(451)	1,100
(Loss) gain on sale and results of Taiwan agency business(iii)	**(621)**	1	(37)
Profit (loss) before tax from continuing operations attributable to shareholders	**746**	(450)	1,063
Tax (charge) credit attributable to shareholders' profit	**(55)**	59	(354)
Discontinued operations (net of tax)	**(14)**		241
Profit (loss) for the year	**677**	(391)	950
Minority interests	**(1)**	(5)	(3)
Total profit (loss) for the year attributable to equity holders of Prudential	**676**	(396)	947

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 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.

(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(h), D3(h) and D4(h) contained within the consolidated financial statements in Item 18.

(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.

IFRS basis operating profits for US operations include the following amounts (net or related change in amortization or deferred acquisition costs, where applicable) so as to derive longer-term investment returns:

	2009	**2008**	**2007**
		(£ million)	
Debt securities:			
Amortization of interest related realized gains and losses	**47**	24	31
Risk margin reserve charge for longer-term credit-related losses (see below)	**(60)**	(41)	(37)
Equity type investments:			
Longer-term returns	**69**	62	47

The risk margin reserve ("RMR") charge for longer-term credit-related losses is based on an average annual RMR of 27, 23 and 22 basis points for 2009, 2008 and 2007 respectively on average book values for the year as shown below:

	2009			**2008**			**2007**		
Moody's rating category (or equivalent under NAIC rating of	**Average book value (US$m)**	**RMR %**	**Annual expected losses US$m**	**Average book value (US$m)**	**RMR %**	**Annual expected losses US$m**	**Average book value (US$m)**	**RMR %**	**Annual expected losses US$m**

RMBS)												
A3 or higher	**19,509**	**0.03**	**(5)**	**(3)**	21,098	0.03	(6)	(3)	20,231	0.03	(6)	(3)
Baa 1, 2, 3	**21,072**	**0.23**	**(47)**	**(30)**	20,145	0.23	(46)	(25)	20,306	0.22	(46)	(23)
Ba 1, 2, 3	**2,035**	**1.13**	**(23)**	**(15)**	1,635	1.11	(18)	(10)	1,687	1.13	(19)	(9)
B1, 2, 3	**594**	**2.86**	**(17)**	**(11)**	514	2.80	(14)	(8)	530	2.88	(15)	(7)
Below B3	**691**	**3.91**	**(27)**	**(17)**	373	3.98	(15)	(8)	240	4.00	(10)	(5)
Total	**43,901**	**0.27**	**(119)**	**(76)**	43,765	0.23	(99)	(54)	42,994	0.22	(96)	(47)
Related change to amortization of deferred acquisition costs (see below)			**25**	**16**			23	13			20	10
Risk margin reserve charge to operating profit for longer-term credit-related losses			**(94)**	**(60)**			(76)	(41)			(76)	(37)

During 2009, the National Association of Insurance Commissioners ("NAIC") changed its approach to the determination of regulatory ratings of residential mortgage backed securities ("RMBS"). This recognized the complexities associated with these investments and the limitations of the credit rating previously applied. The new ratings framework has been applied by an external third party, PIMCO, and provides regulatory rating details for more than 20,000 RMBS securities owned by US insurers at the end of 2009. Jackson has decided to use the ratings resulting from this model to determine the average annual RMR for 2009 as this is considered more relevant information for the RMBS securities concerned. If the previous approach of using Moody's ratings by a Nationally Recognized Statistical Ratings Organization ("NRSROs") such as Moody's, Standard and Poor's or Fitch for these investments had been used this would have resulted in an annual RMR of 31 basis points for 2009, an additional £11 million of annual expected losses for the period. It should be noted that this change has no impact on the valuation applied to these securities within the IFRS statement of financial position and so there is no impact on IFRS profit before tax or shareholder's equity as a result of this change.

The longer-term rates of return for equity-type investments ranged from 6.7 per cent to 7.9 per cent for 2009, 6.3 per cent to 8.4 per cent for 2008, and 8.1 per cent to 10.1 per cent for 2007, depending on the type of investments. These rates are currently based on spreads over ten year US treasury rates of 400 to 600 basis points.

Market value movements on equity-based derivatives and embedded derivatives are also recorded within operating profits based on longer-term investment returns so as to be consistent with the market-related effects on fees and reserve movements for equity-based products. Market value movements on other derivatives are excluded from operating profit, and are included in short-term fluctuations in investment returns.

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

(v)

UK operations transferred its general insurance business to Churchill in 2002, with general insurance commission representing the commission receivable (net of expenses) for Prudential branded general insurance products as part of this arrangement.

(vi)

Short-term fluctuations in investment returns on shareholder-backed business.

	2009	**2008**	**2007**
		(£ million)	
Insurance operations			
Asia	**31**	(138)	15
US	**27**	(1,058)	(18)
UK	**108**	(212)	(47)
Other operations			
IGD hedge costs	**(235)**		
Other	**105**	(313)	(1)
Total	**36**	(1,721)	(51)

General overview of defaults

Prudential incurred defaults of £11 million in 2009 and £206 million in 2008. There were no default losses in 2007. The defaults of £11 million in 2009 were experienced by the UK shareholder-backed annuity business. Jackson experienced less than £1 million of default losses during 2009. Defaults in 2008 of £206 million (including losses on sale) arose primarily in respect of Lehman Brothers (£110 million) and Washington Mutual (£91 million), the majority of which arose in Jackson.

Asian insurance operations

The fluctuations for Asian operations in 2009 of a gain of £31 million primarily relate to strong market performance in Taiwan and Japan partially offset by the fall in the Vietnamese bond markets. For 2008, the fluctuations of a charge of £138 million relate mainly to £81 million for Vietnam, reflecting a significant fall in the Vietnamese bond and equity markets. For 2007, the £15 million of short-term fluctuations primarily reflect strong equity market movements in Vietnam.

US insurance operations

The short-term fluctuations in investment returns for US insurance operations for 2009, 2008 and 2007 comprise the following items:

	2009	2008	2007
		(£ million)	
Short-term fluctuations related to debt securities:			
Charges in the year*			
Defaults		(78)	
Losses on sales of impaired and deteriorating bonds	**(6)**	(130)	(51)
Bond write downs	**(630)**	(419)	(35)
Recoveries/reversals	**5**	3	8
	(631)	(624)	(78)
Less: risk margin charge included in operating profit based on longer-term investment returns	**76**	54	48
Total	**(555)**	(570)	(30)
Interest related gains (losses):			
Arising in the year	**125**	(25)	31
Less: amortization gains and losses arising in current and prior years to operating profit based on longer-term investment returns	**(59)**	(28)	(37)
	66	(53)	(6)
Related change to amortization of deferred acquisition costs	**75**	88	9
Total short-term fluctuations related to debt securities	**(414)**	(535)	(27)
Derivatives (other than equity related): market value movements (net of related change to amortization of deferred acquisition costs)**	**385**	(369)	(19)
Equity type investments: actual less longer-term return (net of related change to amortization of deferred acquisition costs)	**(59)**	(69)	42
Other items (net of related change to amortization of deferred acquisition costs)***	**115**	(85)	(14)
Total	**27**	(1,058)	(18)

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*

The charges on the debt securities of Jackson comprise the following:

Defaults	Bond write-downs	Losses on sale or impaired and deteriorating bonds	Recoveries/ reversals	2009 Total	2008 Total
		(£ million)			

Residential mortgage-based securities					
Prime	268			**268**	25
Alt-A	192	(10)		**182**	138
Sub-prime	49			**49**	4
Total residential mortgage-backed securities	509	(10)		**499**	167
Corporate debt securities	91	16		**107**	441
Other	30		(5)	**25**	16
Total	630	6	(5)	**631**	624

As disclosed above, total 2008 defaults, losses on sale, write-downs and recoveries were £(624) million compared to £(78) million in 2007. Given the smaller scale of losses in 2007, a breakdown by type of debt security has not been provided.

Other bond write-downs and defaults of £30 million relate to Piedmont Securities in 2009. Piedmont is an investment vehicle investing in certain asset-backed and mortgage-backed securities in the US.

**

The gain of £385 million and the charge of £369 million and £19 million value movement for 2009, 2008 and 2007 respectively is for freestanding derivatives held to manage the fixed annuity and other general account business. Under IAS 39, unless hedge accounting is applied, value movements on derivatives are recognized in the income statement.

Derivative value movements in respect of equity risk within variable annuity business are included within the operating profit based on longer-term investment returns to match broadly with the commercial effects to which the variable annuity derivative program relates (subject to some limitations to GMDB liabilities where US GAAP does not fully reflect the economic features being hedged.) Other derivative value movements are separately identified within short-term fluctuations in investment returns.

For the derivatives program attaching to the fixed annuity and other general account business Prudential has continued its approach of not seeking to apply hedge accounting under IAS 39. This decision reflects the inherent constraints of IAS 39 for hedge accounting investments and life assurance assets and liabilities under 'grandfathered' US GAAP under IFRS 4.

***

The £115 million gain (2008: charge of £85 million) for other items shown above comprises a gain of £85 million (2008: charge of £70 million) for the difference between the charge for embedded derivatives included in the operating result and the charge to the total result and a gain of £30 million (2008: charge of £15 million) of other items. For embedded derivatives the operating result reflects the application of 10-year average AA corporate bond rate curves and a static historical equity volatility assumption. The total result reflects the application of year-end AA corporate bond rate curves and current equity volatility levels.

In addition, for US insurance operations, included within the statement of comprehensive income, is a reduction in net unrealized losses on debt securities classified as available-for-sale of £2,669 million for 2009 and an increase in net unrealized losses of £2,104 million and £244 million for 2008 and 2007 respectively. These temporary market value movements do not reflect default or impairments. Additional details on the movement in the value of the Jackson portfolio are included in note D3 to the consolidated financial statements in Item 18.

UK insurance operations

The short-term fluctuations gain of £108 million and charge of £212 million for 2009 and 2008, respectively, reflected primarily asset value movements, principally for shareholder-backed annuity business. The charge of £212 million in 2008 also included £42 million for the effect of credit downgrades on the calculation of liabilities for shareholder-backed annuity business in PRIL and PAC non-profit sub-fund.

IGD hedge costs

During the severe equity market conditions experienced in the first quarter of 2009 coupled with historically high equity volatility Prudential 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 have expired and have not been renewed.

Other operations

Short-term fluctuations of other operations, in addition to the previously discussed IGD hedge costs arise from:

	2009	**2008**	**2007**
		(£ million)	
Unrealized value movements on swaps held centrally to manage Prudential assets and liabilities	**28**	(38)	(18)

Unrealized value movements on Prudential Capital's bond portfolio	**66**	(190)	(24)
Unrealized value movements on investments held by other operations	**11**	(14)	9
Value movements relating to the investment in an India mutual fund		(71)	32
	105	(313)	(1)

(vii)

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

	2009	2008	2007
	(£ million)		
Actuarial gains and losses			
Actual less expected return on scheme assets	**23**	(97)	4
Experience gains and losses on scheme liabilities	**17**	19	(4)
Gains (losses) on changes of assumptions for scheme liabilities	**(147)**	71	(7)
	(107)	(7)	(7)
Less: amount attributable to the PAC with-profits sub-fund	**47**	(2)	6
	(60)	(9)	(1)
Other gains and losses			
Movement in the provision for deficit funding of PSPS	**(48)**	(13)	
Less: amount attributable to the PAC with-profits sub-fund	**34**	9	
	(14)	(4)	
Total	**(74)**	(13)	(1)

The actuarial gains and losses shown in the table above relate to the Scottish Amicable, M&G and until 2009 the small Taiwan defined benefit pension schemes. The amounts did not include actuarial gains and losses for the Prudential Staff Pension Scheme (PSPS) for which Prudential has not recognized its interest in the scheme's underlying surplus.

The losses of £147 million in 2009 on change of assumptions comprise mainly the effect of a decrease in the risk discount rate combined with the effect of increase in inflation rates.

Other gains and losses relate to the change in the year or the provisions for deficit funding obligation for PSPS. Further details on Prudential's defined benefit pension schemes and the effect of the accounting policy change are shown in note I2, contained in the consolidated financial statements in Item 18.

(viii)

Share-based payments.

The charge for share-based payments for Prudential schemes is the same for the Save As You Earn ("SAYE") and Prudential performance-related schemes.

(ix)

Restructuring costs are incurred in the UK as part of the EEV covered business (£16 million, £10 million and £7 million for 2009, 2008 and 2007 respectively) and as part of central operations, or the EEV non-covered business (£7 million, £18 million and £12 million for 2009, 2008 and 2007 respectively).

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 2009, 2008 and 2007:

Year ended December 31, 2009

	Insurance operations			Asset management			Total	Unallocated	
	UK	US	Asia	M&G	US	Asia	segment	corporate	Total
					(£ million)				
Operating profit based on longer-term investment returns	**657**	459	410	238	4	55	1,823	(418)	1,405
Short-term fluctuations in investment returns on shareholder-backed business	**108**	27	31	70			236	(200)	36
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	**(46)**			(14)			(60)	(14)	(74)
Loss on sale and results for Taiwan agency business(i)			(621)				(621)		(621)
Profit (loss) from continuing operations before tax attributable to shareholders	**719**	486	(180)	294	4	55	1,378	(632)	746
Tax attributable to shareholders									(55)
Profit (loss) from continuing operations after tax									691
Discontinued operations									(14)
Profit for the year									677

(i) This comprises loss on sale of Taiwan agency business of £559 million and trading results before tax of £62 million as explained in note I1 of the consolidated financial statements in Item 18.

Year ended December 31, 2008

	Insurance operations			Asset management					
	UK	US	Asia	M&G	US	Asia	Total segment	Unallocated corporate	Total
	(£ million)								
Operating profit based on longer-term investment returns	589	406	231	286	7	52	1,571	(288)	1,283
Short-term fluctuations in investment returns on shareholder-backed business	(212)	(1,058)	(138)	(195)			(1,603)	(118)	(1,721)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes			(2)	(10)			(12)	(1)	(13)
Results for the sold Taiwan agency business			1				1		1
(Loss) profit from continuing operations before tax attributable to shareholders	377	(652)	92	81	7	52	(43)	(407)	(450)
Tax attributable to shareholders									59
Loss for the year									(391)

Year ended December 31, 2007

	Insurance operations			Asset management					
	UK	US	Asia	M&G	US	Asia	Total segment	Unallocated corporate	Total
				(£ million)					
Operating profit based on longer-term investment returns	528	444	125	254	8	72	1,431	(279)	1,152
Short-term fluctuations in investment returns on shareholder-backed business	(47)	(18)	15	4	1		(45)	(6)	(51)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes				5			5	(6)	(1)
Results for the sold Taiwan agency business			(37)				(37)		(37)
Profit/(loss) from continuing operations before tax attributable to shareholders	481	426	103	263	9	72	1,354	(291)	1,063
Tax attributable to shareholders									(354)
Profit/(loss) from continuing operations after tax									709
Discontinued operations									241
Profit for the year									950

IFRS operating profit based on longer-term investment returns

Prudential's operating profit based on longer-term investment returns before tax from continuing operations based on longer-term investment returns on the IFRS basis was £1,405 million in 2009, £1,283 million in 2008 and £1,152 million in 2007.

Insurance operations

In Asia, operating profit based on longer-term investment returns for long-term business increased by 62 per cent from £257 million in 2008 to £416 million in 2009. 2009 included a £63 million one-off release of reserves in the Malaysian life operations determined after assessing the measurement basis for policyholders' liabilities, following the implementation of a Risk Based Capital ("RBC") regime by the Malaysian regulatory authorities. Excluding this item, Asia delivered a strong underlying operating performance resulting in an increase of £96 million to £353 million in 2009 from £257 million for 2008. This increase reflected both underlying growth as Prudential built the in-force book and a reduction in new business strain from a charge of £97 million in 2008 to a charge of £78 million in 2009.

Prudential's larger markets in Asia of Malaysia, Hong Kong, Singapore and Indonesia continued to show strong increases in operating profit based on longer-term investment returns. In Indonesia, the results increased from £55 million in 2008 to £102 million in 2009, reflecting the strong underlying growth of the business and further improvements to the impact of new business on operating profit based on longer-term investment returns. In Malaysia, operating profit based on longer-term investment returns of £65 million in 2009, excluding the one-off credit, was up 41 per cent from £46 million in 2008, driven mainly by the growth in the profits from the in-force business. Hong Kong recorded increased operating profit based on longer-term investment returns up 45 per cent from £33 million in 2008 to £48 million in 2009, due mainly to increased profits from the in-force non-participating business, both as a result of growth and the non-recurrence of one-off costs in 2008. This has been offset by reduced participating fund profits following lower bonus payments to policyholders in 2009 reducing the corresponding transfer to shareholders from the with-profits fund. Singapore saw an increase in operating profit based on longer-term investment returns of £29 million in 2008 (35 per cent) to £112 million in 2009 reflecting growth in the in-force business. Aside from Japan, where on February 15, 2010 the operation suspended writing new business, Taiwan, which is focusing on its bancassurance business following the disposal of its agency business in June 2009, and Thailand, all the Asian life operations generated operating profit based on longer-term investment returns in 2009.

In the US, the long-term business operating profit based on longer-term investment returns increased by 13 per cent from £406 million in 2008 to £459 million in 2009, primarily from the effect of favorable exchange rate movements, increased operating profit based on longer-term investment returns from the fixed and fixed indexed annuity business and lower DAC amortization on variable annuity business as compared to 2008. These increases were offset by the combined negative accounting impact of equity market movements on Jackson's variable annuity business and related hedging program. The hedging program is undertaken on an economic basis and the accounting measurement does not always fully capture the economic effects.

In the UK, the long-term business operating profit based on longer-term investment returns of £606 million in 2009 increased by 11 per cent from £545 million in 2008. This reflected growth from the shareholder-backed annuity business, with operating profit based on longer-term investment returns being £194 million higher than in 2008, partially offset by lower contribution from the with-profits business of £281 million in 2009, compared with £395 million in 2008. The lower profit from the with-profit business reflected the impact of rate reductions in the February 2009 bonus declaration made in response to recent volatile investment performance. These lower bonus payments to policyholders have a corresponding negative impact on operating profit based on longer-term investment returns as they reduce the consequential transfer to shareholders from the with-profit fund, calculated as one-ninth of the cost of policyholders' bonus. Profit from UK general insurance commission increased to £51 million in 2009 from £44 million in 2008. As a result, the total operating profit based on longer-term investment returns increased by 12 per cent in 2009 to £657 million from £589 million in 2008.

Prudential's Asian operations operating profit based on longer-term investment returns for long-term business increased by 84 per cent from £140 million in 2007 to £257 million in 2008. In Indonesia the results increased from £35 million in 2007 to £55 million in 2008 whilst in the established operations (Singapore, Hong Kong and Malaysia) the growth was more muted, growing from £153 million in 2007 to £162 million in 2008. For the Korean operation the result improved from a loss of £13 million in 2007 to a profit of £12 million in 2008. The driver for the growth was the implementation, for IFRS reporting purposes, of a more appropriate basis of deferring and amortizing acquisition costs rather than continuing with the local regulatory basis reporting. The Indian operation posted a loss of £6 million in 2008, before development expenses for the agency field force which is shown separately in the analysis above of operating profit based on longer-term investment returns under "development expenses". The result also reflects that as the business matures it is appropriate to now defer and amortize acquisition costs, resulting in a benefit of £19 million in 2008. The result for other operations increased from £8 million in 2007 to £34 million in 2008 reflecting mainly reserve releases in the Japanese operation.

The US business's operating profit based on longer-term investment returns of £406 million in 2008 was down by nine per cent from £444 million in 2007. This was mainly due to accelerated levels of Variable Annuities DAC amortization as a result of large negative equity market movements. These impacts were partially offset by positive operating derivative income on variable annuity business, reflecting the increase in market value of the net short derivative positions due to falling equity prices.

In the UK business, total operating profit based on longer-term investment returns increased by 12 per cent in 2008 to £589 million from £528 million in 2007. The increase of four per cent achieved

for the long-term business in 2008 as compared to 2007 reflected profits attributable to the with-profits business of £395 million together with 15 per cent growth from the long-term shareholder backed business. IFRS profits from the shareholder annuity business in 2008 included the impact of strengthening the allowance for credit defaults partly offset by profits emerging from a rebalancing of the asset portfolio.
Non-long-term business IFRS profit reflected profit from general insurance commission which increased to £44 million in 2008 from £4 million in 2007, with cash beginning to emerge following the 2002 sale of the business to Churchill.

Asset management business

M&G's operating profit based on longer term investment returns for 2009 was £238 million, a decrease of 17 per cent from £286 million in 2008. This primarily reflected the relative levels of equity and property markets between 2008 and 2009, with the FTSE All Share Index being on average 15 per cent lower in 2009 than in 2008, as well as higher staff costs and lower performance-related fees. These negative impacts were partly offset by revenue earned on the very strong fund net inflows during 2009 (£13.5 billion in 2009 compared with £3.4 billion in 2008).

M&G's operating profit based on longer term investment returns for 2008 was £286 million, an increase of 13 per cent from £254 million in 2007. Higher profits from the fixed income business and higher performance-related fees were partially offset by the negative impact of market conditions, particularly in the retail business.

The Asian asset management operations reported operating profit based on longer term investment returns of £55 million, up by six per cent from £52 million in 2008. This reflects favorable exchange rates and management's focus on profitability during the period. Profit in 2009 was adversely impacted by a one-off loss in India of £6 million.

In Asia, operating profit based on longer-term investment returns for asset management in 2008 was £52 million which represented a 28 per cent decrease against the 2007 operating profit based on longer-term investment returns of £72 million driven by decreasing funds under management and performance-related fees as a result of the market position in 2008.

Unallocated corporate result

Operating profit based on longer-term investment returns for 2009 of £418 million comprised other income and expenditure of £395 million and restructuring costs of £23 million. Operating profit based on longer-term investment returns for 2008 of £288 million comprised other income and expenditure of £260 million and restructuring costs of £28 million. Operating profit based on longer-term investment returns for 2007 of £279 million comprised other income and expenditure of £260 million and restructuring costs of £19 million.

The change of £135 million in other income and expenditure to negative £395 million in 2009 from the negative £260 million in 2008 primarily reflected lower returns on central funds as a result of falling interest rates, an increase in interest payable on core structural borrowings and the non-recurrence in 2009 of a positive one-off 2008 item of profit on the sale of a seed capital investment in an Indian mutual fund.

Other income and expenditure in 2008 at negative £260 million was flat compared to 2007 (negative £260 million).

Analysis of life insurance pre-tax IFRS operating profit based on longer-term investment returns by driver

	2009	2008	2007
	(£ million)		
Investment spread	**1,001**	747	804
Asset management fees	**458**	403	365
Net expense margin	**(388)**	(385)	(443)
DAC amortization (Jackson only)	**(223)**	(450)	(286)
Net insurance margin	**472**	308	273
With-profits business	**310**	425	420
Non-recurrent release of reserves for Malaysian life operation	**63**		
Other	**(218)**	134	(40)
Total long-term business operating profit based on longer-term investment returns	**1,475**	1,182	1,093

The analysis above classifies Prudential's pre-tax operating profit based on longer-term investment returns from long-term insurance operations in 2009, 2008 and 2007 into the underlying drivers of those profits, using the following categories:

(i) Investment spread this represents the difference between net investment income (or premium income in the case of the UK annuities new business) and amounts credited to policyholder accounts.

(ii) Asset management fees this represents profits driven by investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.

(iii) Net expense margin this represents expenses charged to the profit and loss account (excluding those borne by the with-profits fund and those products where earnings are purely protection driven) including amounts relating to movements in deferred acquisition costs, net of any fees or premium loadings related to expenses. Jackson DAC amortization (net of hedging effects), which is intended to be part of the expense margin, has been separately highlighted in the table below.

(iv) Insurance margin this represents profits derived from the insurance risks of mortality, morbidity and persistency, including fees earned on variable annuity guarantees.

(v) With-profits business this represents the shareholders' transfer from the with-profits fund in the period.

(vi) Other represents a mixture of other income and expenses that are not directly allocated to the underlying drivers, including non-recurring items.

An analysis of life insurance pre-tax operating profit based on longer-term investment returns for 2009, 2008 and 2007 by driver and segment is as follows:

	2009			
	Asia	**US**	**UK**	**Total**
	(£ million)			
Investment spread	**56**	**622**	**323**	**1,001**
Asset management fees	**80**	**324**	**54**	**458**
Net expense margin	**(65)**	**(227)**	**(96)**	**(388)**
DAC amortization (Jackson only)		**(223)**		**(223)**
Net insurance margin	**253**	**178**	**41**	**472**
With-profits business	**29**		**281**	**310**
Non-recurrent release of reserves for Malaysian Life operations	**63**			**63**
Other(i)	**(6)**	**(215)**	**3**	**(218)**
Total	**410**	**459**	**606**	**1,475**

	2008			
	Asia	**US**	**UK**	**Total**
	(£ million)			
Investment spread	54	550	143	747
Asset management fees	54	292	57	403
Net expense margin	(79)	(192)	(114)	(385)
DAC amortization (Jackson only)		(450)		(450)
Net insurance margin	198	122	(12)	308
With-profits business	30		395	425
Other(i)	(26)	84	76	134
Total	231	406	545	1,182

	2007			
	Asia	**US**	**UK**	**Total**
	(£ million)			
Investment spread	52	533	219	804
Asset management fees	39	266	60	365
Net expense margin	(119)	(186)	(138)	(443)
DAC amortization (Jackson only)		(286)		(286)
Net insurance margin	142	122	9	273
With-profits business	26		394	420
Other(i)	(15)	(5)	(20)	(40)
Total	125	444	524	1,093

Note:

(i) Asia "other" includes development expenses of £6 million (2008: £26 million, 2007: £15 million). US "other" comprises principally of hedging costs/profits before the allowance for Variable Annuity guarantee fees included within net insurance margin, together with other one-off items. UK "other" in 2008 represents the benefits of a number of one-off items.

Charge for short-term fluctuations in investment returns

In calculating the operating profit based on longer-term investment returns, longer-term investment return assumptions are used rather than actual investment returns achieved. The actual movements in asset values beyond the longer-term assumptions appear in the profit and loss account as short-term fluctuations in investment returns, with the exception of Jackson, where unrealized gains or losses on debt securities feature directly as movements in shareholder reserves.

In 2009, short-term fluctuations of £36 million comprised £166 million relating to insurance operations offset by £130 million in respect of other operations and represented a significant increase over the negative short-term fluctuations of £1,721 million recognized in 2008.

Short-term fluctuations in investment returns for insurance operations of positive £166 million in 2009 comprised £31 million for Asia, £27 million for US operations and £108 million in the UK.

The positive short-term fluctuations of £31 million for Asian insurance operations in 2009 primarily reflected strong market performance in Taiwan and Japan partially offset by the impact of unrealized losses on the debt securities portfolio in Vietnam.

The positive short-term fluctuations of £27 million for US insurance operations in 2009 comprised positive £385 million for market value movements on the free-standing derivatives used to manage the fixed annuity and other general account business, negative £414 million in respect of debt securities, and positive £56 million of other items. The negative £414 million for debt securities reflected the levels of realized gains and losses (including write-downs) in excess of the allowance for longer-term defaults and amortization of interest-related gains included in the operating result adjusted for associated deferred acquisition costs.

The positive short-term fluctuations of £108 million for UK insurance operations in 2009 reflected principally value movements on the assets backing the capital of the shareholder-backed annuity business.

For other operations, the principal component of short-term fluctuations in investment returns in 2009 was a one-off £235 million cost arising from the hedge temporarily put in place during the first quarter, to protect Prudential IGD capital surplus in the light of exceptional market conditions. During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, Prudential entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to its regular operational hedging programs. The residual short-term fluctuations in investment returns for other operations of positive £105 million included £66 million for unrealized appreciation on Prudential Capital's debt securities portfolio and £28 million on swaps held centrally to manage Prudential's assets and liabilities.

The £1,721 million charge for short-term fluctuations in investment returns in 2008 mainly comprised £138 million, £1,058 million and £212 million relating to its Asian, US and UK insurance operations respectively.

The Asian insurance operations' negative short-term fluctuations of £138 million in 2008 primarily reflected movements in Vietnam and Japan of £81 million and £34 million respectively.

The result in Vietnam mainly reflected the two-thirds fall in the Vietnam equity market. In Japan there were a number of contributory factors, the largest of these being losses of £14 million reflecting the 42 per cent fall in the country's stock market and unrealized losses of £13 million on leveraged super senior notes.

Prudential's US results included a £1,058 million charge in 2008 (2007: £18 million charge) for short-term fluctuations in investment returns. This comprised £535 million in respect of debt securities, £439 million in respect of freestanding derivatives and embedded derivative liabilities, £69 million for equity-type securities and a net £15 million for other items.

The £535 million charge for debt securities in 2008 reflected the levels of defaults, losses on sale, and write downs in excess of the allowance for longer-term defaults included in the operating result. The main constituent of the £439 million charge in 2008 was £369 million for freestanding derivatives held to manage the fixed annuity and other general account business. There was also a charge of £70 million in 2008 in respect of Guaranteed Minimum Withdrawal Benefit and other embedded derivative liabilities for the difference between the effect of applying year-end AA corporate bond rate and equity volatility curves in the total result rather than longer-term levels, as applied in determining the operating result.

The UK insurance operations' short-term fluctuations charge of £212 million in 2008 reflected asset value movements, principally for the shareholder-backed annuity business, of negative £170 million and £42 million for the effect of credit downgrades on the measurement of annuity liabilities.

Other short-term fluctuations charge of £313 million in 2008 included £190 million for unrealized value movements in Prudential Capital and £71 million on the sale of an investment in an Indian Mutual Fund.

Sale of Taiwan agency business

On February 20, 2009 Prudential announced its agreement to transfer the assets and liabilities of the agency distribution business in Taiwan, including the capital consuming in-force book, to China Life Insurance Limited (Taiwan). The transaction completed on June 19, 2009 following regulatory approval being given on that day. The transfer has resulted in a one-off negative pre-tax impact of £621 million. After allowing for tax, and other adjustments, the effect on shareholders' equity was negative £607 million. The overall size of loss reflects the carrying value of the IFRS equity of the business as applied in the calculation of the loss on sale and the application of "grandfathered" US GAAP under IFRS 4 for insurance assets and liabilities. US GAAP does not and is not designed to include the costs of holding economic capital to support the legacy interest rate guaranteed products. The loss on sale reflects this element of the economic value. Separately, it is to be noted that under IFRS there is no recognition of the enhanced IGD capital surplus position arising on completion.

Presentation of results before tax and effective rate of 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 delineates between policyholder and shareholder components.

	2009	**2008**	**2007**
		(£ million)	
Tax (charge) credit	**(873)**	1,683	(349)
Less: tax credit (charge) attributable to policyholders' returns	**818**	(1,624)	(5)
Tax (charge) credit attributable to shareholders' returns	**(55)**	59	(354)

The effective rate of tax attributable to shareholders' profits on operating profit based on longer-term investment returns, was 23 per cent in 2009 (2008: 23 per cent). The effective rate of tax attributable to shareholders' profits at the total profit level for continuing operations was seven per cent in 2009 (2008: 13 per cent) due to the ability to utilize losses carried forward for which Prudential was previously unable to recognize a deferred tax asset in Jackson, partially offset by the absence of tax relief on the loss on the disposal of the Taiwan agency business.

The effective rate of tax attributable to shareholders' profits on operating profit based on longer-term investment returns, was 23 per cent in 2008 (2007: 31 per cent). The effective rate of tax attributable to shareholders' profits at the total profit level for continuing operations was 13 per cent in 2008 (2007: 33 per cent). The effective rate of tax on operating profit based on longer-term investment returns was lower in 2008 than 2007, reflecting a combination of the settlement of issues with HM Revenue and Customs at amounts below those previously provided and a reduction in amounts previously provided on outstanding issues with HM Revenue and Customs. The effective rate of tax at total profit level in 2008 was lower than expected, substantially due to a restriction on the ability to recognize deferred tax assets on all losses in Asia and the US.

IFRS Earnings per share

	2009	**2008**	**2007**
EPS based on operating profit based on longer-term investment returns after tax and minority interest	**43.3p**	39.9p	32.5p
Basic EPS based on total profit (loss) after minority interest	**27.0p**	(16.0)p	38.7p

Explanation of Movements in Profits Before Shareholder Tax by Nature of Revenue and Charges

The following table shows Prudential's consolidated total revenue and consolidated total charges for the periods presented:

	Year Ended December 31, 2009	2008	2007
	(£ million)		
Gross earned premiums[(a)]	**20,299**	18,993	18,359
Outward reinsurance premiums	**(323)**	(204)	(171)
Earned premiums, net of reinsurance	**19,976**	18,789	18,188
Investment return[(b)]	**26,889**	(30,202)	12,225
Other income	**1,234**	1,146	2,457
Total revenue, net of reinsurance	**48,099**	(10,267)	32,870
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance[(c)]	**(41,195)**	10,824	(26,785)
Acquisition costs and other operating expenditure[(d)]	**(4,572)**	(2,459)	(4,859)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(209)**	(172)	(168)
Loss on sale of Taiwan agency business	**(559)**		
Total charges, net of reinsurance	**(46,535)**	8,193	(31,812)
Profit (loss) before tax *(being tax attributable to shareholders' and policyholders' returns)**	**1,564**	(2,074)	1,058
Tax (charge) credit attributable to policyholders' returns	**(818)**	1,624	5
Profit(loss) before tax attributable to shareholders	**746**	(450)	1,063
Tax (charge)credit attributable to shareholders' returns	**(55)**	59	(354)
Profit (loss) from continuing operations after tax	**691**	(391)	709
Discontinued operations (net of tax)[(e)]	**(14)**		241
Profit (loss) for the year	**677**	(391)	950

* 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" under IFRS Critical Accounting Policies section above for further explanation.

(a) Gross earned premiums

	Year Ended December 31, 2009	2008	2007
	(£ million)		
Asian Operations	**5,345**	5,333	5,022
US Operations	**9,197**	6,032	5,860
UK Operations	**5,757**	7,628	7,477
Total	**20,299**	18,993	18,359

Gross earned premiums for insurance operations totaled £20,299 million in 2009, up seven per cent from £18,993 million in 2008. The increase of £1,306 million in 2009 was primarily driven by growth of £3,165 million in the US operations that was partially offset by a decrease of £1,871 million in the UK operations.

Gross earned premiums for insurance operations totaled £18,993 million in 2008 compared to £18,359 million in 2007. The increase in gross earned premiums in 2008 against 2007 was driven by growth across all regions during the year.

Asia

Gross earned premiums were flat in 2009, increasing by £12 million from £5,333 million in 2008 to £5,345 million. This reflects in part the fall in new business premiums across the Asian life insurance industry, particularly for single premium and investment-linked products, seen in the first half of 2009, being offset by strong sales in the fourth quarter of 2009 as consumer confidence returned to the retail financial services sector.

Gross earned premiums increased by six per cent to £5,333 million in 2008 compared to £5,022 million in 2007, aided by exchange rate movements during the year.

Prudential has focused on the sales of capital efficient unit-linked products in Asia, and is particularly strong in the regular premium savings sector. In recent years, Prudential has increased its focus on higher-margin protection products, both as riders to savings policies and on a standalone basis.

United States

Gross earned premiums increased by 52 per cent from £6,032 million in 2008 to £9,197 million in 2009. This increase reflected both the beneficial effects of exchange rate movements compared to 2008, as well as the highest level of variable annuity sales in the company's history, driven by the stabilization of US equity markets that began in the second quarter of 2009. Jackson also experienced an increase in sales of fixed index annuities as a result of increased customer demand for products with a guaranteed rate of return. These increases were slightly offset by the restriction made by the company on the sales of institutional guaranteed investment contracts.

Gross earned premiums increased by three per cent from £5,860 million in 2007 to £6,032 million in 2008. This increase was mainly as a result of exchange rate movements during the year, with a decrease in underlying variable annuity sales reflecting continued volatility in US equity markets in 2008 and intense price competition partially offset by increases in fixed annuity sales reflecting changing customer demands.

United Kingdom

Gross earned premiums for the UK operations decreased by 25 per cent from £7,628 million in 2008 to £5,757 million in 2009. Sales of with-profits bonds increased by 35 per cent on 2008 in 2009 but this was more than offset by lower sales of retail products due to persisting challenging market conditions and also reflecting Prudential's focus on value over volume. Additionally, 2008 included a large bulk annuity transaction which was not repeated in 2009, due to the unavailability of transactions which met Prudential's return criteria.

Gross earned premiums for Prudential UK increased by two per cent in the year from £7,477 million in 2007 to £7,628 million in 2008, primarily driven by strong growth in with-profits bonds supplemented by growth in offshore products and PruHealth, amongst other items.

(b) Investment return

	Year Ended December 31,		
	2009	**2008**	**2007**
		(£ million)	
Asian Operations	**4,431**	(4,156)	1,818
US Operations	**5,138**	(5,409)	2,140
UK Operations	**17,786**	(20,435)	8,396
Unallocated corporate and intra-group elimination	**(466)**	(202)	(129)
Total	**26,889**	(30,202)	12,225

Investment return principally comprises interest income, dividends, investment appreciation/depreciation (realized and unrealized gains and losses) on investments designated as fair value through profit and loss and realized gains and losses, including impairment losses, on Jackson's debt securities designated as available-for-sale. Movements in unrealized appreciation/depreciation of Jackson's debt securities designated as available for-sale are not reflected in investment return but are recorded instead in other comprehensive income.

Allocation of investment return between policyholders and shareholders

Investment return is attributable to policyholders and shareholders. A key feature of the accounting policies under IFRS is that the investment return included in the income statement relates to all investment assets of Prudential, irrespective of whether the return is attributable to shareholders, or to policyholders or the unallocated surplus of with-profits funds, the latter two of which have no net impact on shareholders' profit. The table below provides a breakdown of the investment return for each regional operation attributable to each type of business:

	Year Ended December 31, 2009	2008	2007
		(£ million)	
Asian operations			
Policyholder returns			
Assets backing unit-linked liabilities	**2,539**	(2,552)	753
With-profits business	**1,519**	(1,611)	866
	4,058	(4,163)	1,619
Shareholder returns	**373**	7	199
Total	**4,431**	(4,156)	1,818
US operations			
Policyholder returns			
Assets held to back (separate account) unit-linked liabilities	**3,760**	(5,925)	620
Shareholder returns			
Realized gains and losses (including impairment losses on available-for-sale bonds)	**(529)**	(651)	(47)
Value movements on derivative hedging program for general account business	**340**	(311)	19
Interest/dividend income and value movements on other financial instruments for which fair value movements are booked in the income statement	**1,567**	1,478	1,548
	1,378	516	1,520
Total	**5,138**	(5,409)	2,140
UK operations			
Policyholder returns			
Scottish Amicable Insurance Fund (SAIF)	**1,438**	(2,095)	849
Assets held to back unit-linked liabilities	**2,947**	(2,971)	515
With-profits fund (excluding SAIF)	**10,461**	(14,595)	5,881
	14,846	(19,661)	7,245
Shareholder returns			
Prudential Retirement Income Limited (PRIL)	**1,827**	(684)	216
Other business	**1,113**	(90)	935
	2,940	(774)	1,151
Total	**17,786**	(20,435)	8,396
Unallocated corporate			
Shareholder returns	**(466)**	(202)	(129)
Group total			
Policyholder returns	**22,664**	(29,749)	9,484
Shareholder returns	**4,225**	(453)	2,741
Total	**26,889**	(30,202)	12,225

Policyholder returns

The returns, as shown in the table above, are delineated between those returns allocated to policyholders and those allocated to shareholders. In making this distinction, returns allocated to policyholders are those from investments in which shareholders have no direct economic interest, namely:

- unit-linked business in the UK and Asia and SAIF in the UK, for which the investment return is wholly attributable to policyholders,

- separate account business of US operations, the investment return of which is also wholly attributable to policyholders, and

- with-profits business (excluding SAIF) in the UK and Asia (in which the shareholders' economic interest, and the basis of recognizing IFRS basis profits, is restricted to a share of the actuarially determined surplus for distribution (in the UK, 10 per cent). Except for this surplus, the investment return of the with-profit funds is attributable to policyholders (through the asset-share liabilities) or the unallocated surplus, which is accounted for as a liability under IFRS 4.

The assets of these three types of business represented 72 per cent of the total investments of Prudential as at December 31, 2009. The investment return related to the types of business above does not affect shareholders' profits directly. However, there is an indirect impact, for example, investment-related fees or the effect of investment return on the shareholders' share of the cost of bonuses of with-profits funds.

Investment returns for unit-linked and similar products have a reciprocal impact on benefits and claims, with a decrease in market returns on the attached pool of assets affecting policyholder benefits on these products. Similarly, for with-profits funds there is a close correlation between increases or decreases in investment returns and the level of combined charge for policyholder benefits and movement on unallocated surplus that arises from such returns.

Shareholder returns

For shareholder-backed non-participating business of the UK (comprising PRIL and other non-linked non-participating business) and of the Asian operations, the investment return is not directly attributable to policyholders and therefore does impact shareholders' profit directly. However, it should be noted that for UK shareholder-backed annuity business, principally PRIL, where the durations of asset and liability cash flows are normally closely matched, the discount rate applied to measure liabilities to policyholders (under grandfathered UK GAAP under IFRS 4) reflects movements in asset yields (after allowances for the future defaults) of the backing portfolios. Therefore, the net impact on the shareholders' profits of the investment return of the assets backing the liabilities of UK shareholder-backed annuity business is after taking into account the consequential effect on the movement in policyholder liabilities.

Changes in shareholder investment returns for US operations reflect primarily movements in investment income, movements in the value of the derivative instruments held to manage the general account assets and liability portfolio, and realized gains and losses. However, separately reflecting Jackson's types of business, an allocation is made to policyholders through the application of crediting rates. The shareholder investment return for US operations also includes the fair value movement of the derivatives and the movement on the related liabilities of the variable annuity guarantees under Jackson's dynamic hedging program, as described in section "Group Risk Framework Risk exposures Equity Risk" under Item 4.

The majority of the investments held to back the US non-participating business are debt securities for which the available-for-sale designation is applied for IFRS basis reporting. Under this designation the return included in the income statement reflects the aggregate of investment income and realized gains and losses (including impairment losses). However, movements in unrealized appreciation are booked directly to equity. The return on these assets is attributable to shareholders.

Reasons for year-on-year changes in investment returns

With two exceptions, all Prudential investments are carried at fair value in the statement of financial position with fair value movements, which are volatile from year to year, recorded in the income statement. The exceptions are for:

(i) debt securities of the US operations, which are accounted for on an IAS 39 available-for-sale basis, in respect of which realized gains and losses (including impairment losses) are recorded in the income statement, while movements in unrealized appreciation (depreciation) are booked as other comprehensive income. As a result, the changes in fair value of these debt securities are not reflected in Prudential's investment return in the income statement. The unrealized gains and losses in the income statement of US operations primarily arise on the assets of the US separate account business; and

(ii) loans and receivables, which are carried at amortized cost.

Subject to the effect of these two exceptions, the year-on-year changes in investment return primarily reflect the generality of overall market movements for equities, debt securities and, in the UK, for investment property. In addition, for Asian and US separate account business, foreign exchange rates affect the sterling value of the translated income. Consistent with the treatment applied for other items of income and expenditure, investment returns for overseas operations are translated at average exchange rates.

Asia

The table below provides an analysis of investment return attributable to Asian operations for the periods presented:

	Year Ended December 31,		
	2009	**2008**	**2007**
		(£ million)	
Interest/dividend income (including foreign exchange gains and losses)	**625**	302	462
Investment appreciation (depreciation)	**3,806**	(4,458)	1,356
Total	**4,431**	(4,156)	1,818

In Prudential's Asian operations, debt securities accounted for 43 per cent, 51 per cent and 38 per cent of the total investment portfolio as at December 31, 2009, 2008 and 2007, respectively, with equities comprising 48 per cent, 37 per cent and 54 per cent, respectively. The remaining nine per cent, 12 per cent and eight per cent of the total investment portfolio, respectively, primarily comprised loans and deposits with credit institutions. In Asia, investment return increased by £8,587 million in 2009 to £4,431 million. This increase was due to an increase of £323 million in interest and dividend income (including foreign exchange gains and losses) and an £8,264 million increase in investment appreciation, including realized and unrealized gains and losses. The increase of £8,264 million in investment appreciation primarily reflected the effect of the strong performance of Asian equity markets in 2009, in comparison to the significant downturns experienced in 2008.

In 2008, investment return decreased by £5,974 million from a £1,818 million credit in 2007 to a £4,156 million charge in 2008. This decrease was due to a £160 million decrease in interest/dividend income (including foreign exchange gains and losses) and a decrease of £5,814 million in investment appreciation compared to 2007. The decrease of £5,814 million in investment appreciation was primarily the result of volatility in the Asian financial markets in 2008, reflecting a combined effect of the significant downturn in the Asian equity markets partially offset by the effects of bond yield declines.

United States

The table below provides an analysis of investment return attributable to US operations for the periods presented:

	Year Ended December 31,		
	2009	2008	2007
	(£ million)		
Realized losses (including impairment losses on available-for-sale bonds)	**(529)**	(651)	(47)
Investment return of investments backing US separate account liabilities	**3,760**	(5,925)	620
Other investment return	**1,907**	1,167	1,567
Total	**5,138**	(5,409)	2,140

In Prudential's US operations, investment return increased from a charge of £5,409 million in 2008 to a credit of £5,138 million in 2009. The significant £10,547 million favorable change was due to a £122 million decrease in realized losses on available-for-sale debt securities, an increase of £9,685 million in investment return of investments backing the US variable annuity separate account liabilities and an increase of £740 million in other investment returns. Realized losses in 2009 of £529 million included mainly losses incurred in the debt securities portfolio due to write downs and losses on the sale of bonds. The primary driver of the increase in the US investment return was the increase in returns on investments backing the US variable annuity separate account liabilities as a result of significantly more favorable movements in US equity markets in 2009. The increase of £740 million in other investment return was mainly accounted for by the movement in the fair value of derivatives held to manage the general account business, which was a positive £340 million in 2009 compared to a negative of £311 million in 2008.

Investment return decreased by £7,549 million from a £2,140 million credit in 2007 to a £5,409 million charge in 2008. This decrease was due to a £604 million increase in realized losses on debt securities classified as available-for-sale, a decrease in the investment return of the investments backing the US variable annuity separate account liabilities of £6,545 million and a decrease of £400 million in other investment returns. Realized losses in 2008 were £651 million compared to £47 million in 2007 and were related to losses incurred in the debt securities portfolio due to defaults, losses on the sale of bonds and write downs. The primary driver of the decrease in the US investment return was the reduction in returns on investments backing the US variable annuity separate account liabilities as a result of adverse movements in US equity markets. The investment return of the investment assets backing US separate account liabilities decreased by £6,545 million from a £620 million credit in 2007 to a £5,925 million charge in 2008. The decrease of £400 million in other investment return was mainly accounted for by a £311 million decrease in the fair value of derivatives held to manage the general account business.

United Kingdom

The table below provides an analysis of investment return attributable to UK operations for the periods presented:

	Year Ended December 31,		
	2009	**2008**	**2007**
		(£ million)	
Interest/dividend income	**6,628**	7,117	6,763
Foreign exchange gains and losses(i)	**921**	(2,964)	(101)
Investment appreciation (depreciation)(ii)	**10,237**	(24,588)	1,734
Total	**17,786**	(20,435)	