

PRUDENTIAL PLC
Form 6-K
March 13, 2019

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the month of March, 2019

PRUDENTIAL PUBLIC LIMITED COMPANY

(Translation of registrant's name into English)

LAURENCE POUNTNEY HILL,
LONDON, EC4R 0HH, ENGLAND
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports
under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark whether the registrant by furnishing the information
contained in this Form is also thereby furnishing the information to the
Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

If "Yes" is marked, indicate below the file number assigned to the registrant
in connection with Rule 12g3-2(b): 82-

International Financial Reporting Standards (IFRS) Basis Results

Consolidated income statement

| | Note | 2018 £m | 2017 £m |
|---|------|----------|---------|
| Gross premiums earned | | 47,224 | 44,005 |
| Outward reinsurance premiumsnote (i) | | (14,023) | (2,062) |
| Earned premiums, net of reinsurance | | 33,201 | 41,943 |

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| | | | |
|---|------|----------|----------|
| Investment return | | (10,263) | 42,189 |
| Other income note (ii) | | 1,993 | 2,258 |
| Total revenue, net of reinsurance | | 24,931 | 86,390 |
| Benefits and claims note (i) | | (27,411) | (71,854) |
| Outward reinsurers' share of benefit and claims note (i) | | 13,554 | 2,193 |
| Movement in unallocated surplus of with-profits funds | | 1,289 | (2,871) |
| Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance | | (12,568) | (72,532) |
| Acquisition costs and other expenditure note (ii) | B2 | (8,855) | (9,993) |
| Finance costs: interest on core structural borrowings of shareholder-financed businesses | | (410) | (425) |
| (Loss) gain on disposal of businesses and corporate transactions | D1.1 | (80) | 223 |
| Remeasurement of the sold Korea life business | | – | 5 |
| Total charges, net of reinsurance and (loss) gain on disposal of businesses | | (21,913) | (82,722) |
| Share of profits from joint ventures and associates, net of related tax | | 291 | 302 |
| Profit before tax (being tax attributable to shareholders' and policyholders' returns) note (iii) | | 3,309 | 3,970 |
| Less tax credit (charge) attributable to policyholders' returns | | 326 | (674) |
| Profit before tax attributable to shareholders | B1.1 | 3,635 | 3,296 |
| Total tax charge attributable to policyholders and shareholders | B4 | (296) | (1,580) |
| Adjustment to remove tax (credit) charge attributable to policyholders' returns | | (326) | 674 |
| Tax charge attributable to shareholders' returns | B4 | (622) | (906) |
| Profit for the year | | 3,013 | 2,390 |
| Attributable to: | | | |
| Equity holders of the Company | | 3,010 | 2,389 |
| Non-controlling interests | | 3 | 1 |
| Profit for the year | | 3,013 | 2,390 |

| | | | |
|--|------|--------|-------|
| Earnings per share (in pence) Based on profit attributable to the equity holders of the Company: | Note | 2018 | 2017 |
| | B5 | | |
| Basic | | 116.9p | 93.1p |
| Diluted | | 116.8p | 93.0p |

| | | | |
|---|------|--------|--------|
| Dividends per share (in pence) | Note | 2018 | 2017 |
| Dividends relating to reporting year: | B6 | | |
| First interim ordinary dividend | | 15.67p | 14.50p |
| Second interim ordinary dividend | | 33.68p | 32.50p |
| Total | | 49.35p | 47.00p |
| Dividends paid in reporting year: | B6 | | |
| Current year first interim dividend | | 15.67p | 14.50p |
| Second interim ordinary dividend for prior year | | 32.50p | 30.57p |
| Total | | 48.17p | 45.07p |

Notes

(i)

Outward reinsurance premiums include the £(12,149) million paid during the year in respect of the reinsurance of the UK annuity portfolio. The associated increase in reinsurance assets is included in outward reinsurers' share of benefits and claims and the consequential change to policyholder liabilities is included in benefits and claims. See note D1.1 for further details.

(ii)

The 2017 comparative results have been re-presented from those previously published for the deduction of certain expenses against revenue following the adoption of IFRS 15. See note A2.

(iii)

This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders. This is principally because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure is not representative of pre-tax profits attributable to shareholders. Profit before all taxes is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of with-profits funds after adjusting for taxes borne by policyholders.

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of comprehensive income

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| | Note | 2018 £m | 2017 £m |
|--|---------|---------|---------|
| Profit for the year | | 3,013 | 2,390 |
| Other comprehensive income (loss): | | | |
| Items that may be reclassified subsequently to profit or loss | | | |
| Exchange movements on foreign operations and net investment hedges: | | | |
| Exchange movements arising during the year | A1 | 344 | (404) |
| Cumulative exchange gain of sold Korea life business recycled through profit or loss | | – | (61) |
| Related tax | | 5 | (5) |
| | | 349 | (470) |
| Net unrealised valuation movements on securities of US insurance operations classified as available-for-sale: | | | |
| Net unrealised holding (losses) gains arising in the year | | (1,606) | 591 |
| (Deduct net gains) add back net losses included in the income statement on disposal and impairment | | (11) | 26 |
| Total | C3.2(c) | (1,617) | 617 |
| Related change in amortisation of deferred acquisition costs | C5.2 | 246 | (76) |
| Related tax | C8.1 | 288 | (55) |
| | | (1,083) | 486 |
| Total | | (734) | 16 |
| Items that will not be reclassified to profit or loss | | | |
| Shareholders' share of actuarial gains and losses on defined benefit pension schemes: | | | |
| Actuarial gains and losses on defined benefit pension schemes | | 134 | 200 |
| Related tax | | (23) | (33) |
| | | 111 | 167 |
| Deduct amount attributable to UK with-profit funds transferred to unallocated surplus of with-profit funds, net of related tax | | (38) | (78) |
| | | 73 | 89 |
| Other comprehensive (loss) income for the year, net of related tax | | (661) | 105 |
| Total comprehensive income for the year | | 2,352 | 2,495 |
| Attributable to: | | | |
| Equity holders of the Company | | 2,348 | 2,494 |
| Non-controlling interests | | 4 | 1 |
| Total comprehensive income for the year | | 2,352 | 2,495 |

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of changes in equity

Year ended 31 December 2018 £m

| Share capital | Share premium | Retained earnings | Translation reserve | Available-for-sale securities reserves | Shareholders' equity | Non-controlling interests | Total equity |
|---------------|---------------|-------------------|---------------------|--|----------------------|---------------------------|--------------|
|---------------|---------------|-------------------|---------------------|--|----------------------|---------------------------|--------------|

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| | Note | C10 | C10 | | | | | | |
|---|------|-----|-----|---------|-----|---------|---------|---|---------|
| Reserves | | | | | | | | | |
| Profit for the year | | – | – | 3,010 | – | – | 3,010 | 3 | 3,013 |
| Other comprehensive income: | | | | | | | | | |
| Exchange movements on foreign operations and net investment hedges, net of related tax | | – | – | – | 348 | – | 348 | 1 | 349 |
| Net unrealised valuation movements, net of related change in amortisation of deferred acquisition costs and related tax | | – | – | – | – | (1,083) | (1,083) | – | (1,083) |
| Shareholders' share of actuarial gains and losses on defined benefit pension schemes, net of related tax | | – | – | 73 | – | – | 73 | – | 73 |
| Total other comprehensive income (loss) | | – | – | 73 | 348 | (1,083) | (662) | 1 | (661) |
| Total comprehensive income for the year | | – | – | 3,083 | 348 | (1,083) | 2,348 | 4 | 2,352 |
| Dividends | B6 | – | – | (1,244) | – | – | (1,244) | – | (1,244) |
| Reserve movements in respect of share-based payments | | – | – | 69 | – | – | 69 | – | 69 |
| Change in non-controlling interests | D1.2 | – | – | – | – | – | – | 7 | 7 |
| Movements in respect of option to acquire non-controlling interests | D1.2 | – | – | (109) | – | – | (109) | – | (109) |
| Share capital and share premium | | | | | | | | | |
| New share capital subscribed | C10 | 1 | 16 | – | – | – | 17 | – | 17 |
| Treasury shares | | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | | – | – | 29 | – | – | 29 | – | 29 |
| Movement in Prudential plc shares purchased by unit trusts consolidated | | – | – | 52 | – | – | 52 | – | 52 |

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under IFRS

| | | | | | | | | |
|-----------------------------------|-----|-------|--------|-------|---------|--------|----|--------|
| Net increase (decrease) in equity | 1 | 16 | 1,880 | 348 | (1,083) | 1,162 | 11 | 1,173 |
| At beginning of year | 129 | 1,948 | 12,326 | 840 | 844 | 16,087 | 7 | 16,094 |
| At end of year | 130 | 1,964 | 14,206 | 1,188 | (239) | 17,249 | 18 | 17,267 |

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of changes in equity

Year ended 31 December 2017 £m

| | | Share capital | Share premium | Retained earnings | Translation reserve | Available-for-sale securities reserves | Shareholders' equity | Non-controlling interests | Total equity |
|---|------|---------------|---------------|-------------------|---------------------|--|----------------------|---------------------------|--------------|
| | Note | C10 | C10 | | | | | | |
| Reserves | | | | | | | | | |
| Profit for the year | – | – | 2,389 | – | – | – | 2,389 | 1 | 2,390 |
| Other comprehensive income: | | | | | | | | | |
| Exchange movements on foreign operations and net investment hedges, net of related tax | – | – | – | (470) | – | – | (470) | – | (470) |
| Net unrealised valuation movements, net of related change in amortisation of deferred acquisition costs and related tax | – | – | – | – | – | 486 | 486 | – | 486 |
| Shareholders' share of actuarial gains and losses on defined benefit pension schemes, net of related tax | – | – | 89 | – | – | – | 89 | – | 89 |
| Total other comprehensive income (loss) | – | – | 89 | (470) | – | 486 | 105 | – | 105 |
| Total comprehensive income for the year | – | – | 2,478 | (470) | – | 486 | 2,494 | 1 | 2,495 |
| Dividends | B6 | – | – | (1,159) | – | – | (1,159) | – | (1,159) |
| Reserve movements in respect of share-based payments | – | – | 89 | – | – | – | 89 | – | 89 |
| Change in non-controlling interests | – | – | – | – | – | – | – | 5 | 5 |

| | | | | | | | | | |
|--|-----|-----|-------|--------|-------|-----|--------|---|--------|
| Share capital and share premium | | | | | | | | | |
| New share capital subscribed | C10 | – | 21 | – | – | – | 21 | – | 21 |
| Treasury shares | | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | | – | – | (15) | – | – | (15) | – | (15) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | – | – | (9) | – | – | (9) | – | (9) |
| Net increase (decrease) in equity | | – | 21 | 1,384 | (470) | 486 | 1,421 | 6 | 1,427 |
| At beginning of year | | 129 | 1,927 | 10,942 | 1,310 | 358 | 14,666 | 1 | 14,667 |
| At end of year | | 129 | 1,948 | 12,326 | 840 | 844 | 16,087 | 7 | 16,094 |

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of financial position

| | Note | 31 Dec 2018 £m | 31 Dec 2017 £m |
|---|------|----------------|----------------|
| Assets | | | |
| Goodwill | C5.1 | 1,857 | 1,482 |
| Deferred acquisition costs and other intangible assets | C5.2 | 11,923 | 11,011 |
| Property, plant and equipment | | 1,409 | 789 |
| Reinsurers' share of insurance contract liabilities | | 11,144 | 9,673 |
| Deferred tax assets | C8 | 2,595 | 2,627 |
| Current tax recoverable | | 618 | 613 |
| Accrued investment income | | 2,749 | 2,676 |
| Other debtors | | 4,088 | 2,963 |
| Investment properties | | 17,925 | 16,497 |
| Investment in joint ventures and associates accounted for using the equity method | | 1,733 | 1,416 |
| Loans | C3.3 | 18,010 | 17,042 |
| Equity securities and portfolio holdings in unit trustsnote (i) | | 214,733 | 223,391 |
| Debt securitiesnote (i) | C3.2 | 175,356 | 171,374 |
| Derivative assets | | 3,494 | 4,801 |
| Other investmentsnote (i) | | 6,512 | 5,622 |
| Deposits | | 11,796 | 11,236 |
| Assets held for salenote (ii) | | 10,578 | 38 |
| Cash and cash equivalents | C1 | 12,125 | 10,690 |
| Total assets | C1 | 508,645 | 493,941 |
| Equity | | | |
| Shareholders' equity | | 17,249 | 16,087 |
| Non-controlling interests | | 18 | 7 |
| Total equity | | 17,267 | 16,094 |

| Liabilities | | | |
|--|------|---------|---------|
| Insurance contract liabilities | C4.1 | 322,666 | 328,172 |
| Investment contract liabilities with discretionary participation features | C4.1 | 67,413 | 62,677 |
| Investment contract liabilities without discretionary participation features | C4.1 | 19,222 | 20,394 |
| Unallocated surplus of with-profits funds | C4.1 | 15,845 | 16,951 |
| Core structural borrowings of shareholder-financed businesses | C6.1 | 7,664 | 6,280 |
| Operational borrowings attributable to shareholder-financed businesses | C6.2 | 998 | 1,791 |
| Borrowings attributable to with-profits businesses | C6.2 | 3,940 | 3,716 |
| Obligations under funding, securities lending and sale and repurchase agreements | | 6,989 | 5,662 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | | 11,651 | 8,889 |
| Deferred tax liabilities | C8 | 4,022 | 4,715 |
| Current tax liabilities | | 568 | 537 |
| Accruals, deferred income and other liabilities | C1 | 15,248 | 14,185 |
| Provisions | | 1,078 | 1,123 |
| Derivative liabilities | | 3,506 | 2,755 |
| Liabilities held for salenote (ii) | | 10,568 | – |
| Total liabilities | C1 | 491,378 | 477,847 |
| Total equity and liabilities | | 508,645 | 493,941 |

Notes

(i)

Included within equity securities and portfolio holdings in unit trusts, debt securities and other investments are £8,278 million (31 December 2017: £8,232 million) of lent securities and assets subject to repurchase agreements.

(ii)

Assets held for sale of £10,578 million include £10,568 million in respect of the reinsured UK annuity business. A corresponding amount is reflected in liabilities held for sale. See note D1.1 for further details.

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of cash flows

| | Note | 2018 £m | 2017 £m |
|--|------|----------|----------|
| Cash flows from operating activities | | | |
| Profit before tax (being tax attributable to shareholders' and policyholders' returns)note (i) | | 3,309 | 3,970 |
| Adjustments to profit before tax for non-cash movements in operating assets and liabilities: | | | |
| Investments | | 15,456 | (49,771) |
| Other non-investment and non-cash assets | | (3,503) | (968) |
| Policyholder liabilities (including unallocated surplus) | | (17,392) | 44,877 |
| Other liabilities (including operational borrowings) | | 4,344 | 3,360 |
| Interest income and expense and dividend income included in result before tax | | (7,861) | (8,994) |
| Operating cash items: | | | |
| Interest receipts and payments | | 5,793 | 6,900 |
| Dividend receipts | | 2,361 | 2,612 |
| Tax paidnote (iv) | | (625) | (915) |

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| | | |
|--|---------|---------|
| Other non-cash items | 582 | 549 |
| Net cash flows from operating activities | 2,464 | 1,620 |
| Cash flows from investing activities | | |
| Purchases of property, plant and equipment | (289) | (134) |
| Proceeds from disposal of property, plant and equipment | 4 | – |
| Acquisition of businesses and intangiblesnote (v) | (504) | (351) |
| Sale of businessesnote (v) | – | 1,301 |
| Net cash flows from investing activities | (789) | 816 |
| Cash flows from financing activities | | |
| Structural borrowings of the Group: | | |
| Shareholder-financed businesses:note (ii) | C6.1 | |
| Issue of subordinated debt, net of costs | 1,630 | 565 |
| Redemption of subordinated debt | (434) | (751) |
| Fees paid to modify terms and conditions of senior debtnote (ii) | (33) | – |
| Interest paid | (376) | (369) |
| With-profits businesses:note (iii) | C6.2 | |
| Redemption of subordinated debt | (100) | – |
| Interest paid | (4) | (9) |
| Equity capital: | | |
| Issues of ordinary share capital | 17 | 21 |
| Dividends paid | (1,244) | (1,159) |
| Net cash flows from financing activities | (544) | (1,702) |
| Net increase in cash and cash equivalents | 1,131 | 734 |
| Cash and cash equivalents at beginning of year | 10,690 | 10,065 |
| Effect of exchange rate changes on cash and cash equivalents | 304 | (109) |
| Cash and cash equivalents at end of year | 12,125 | 10,690 |

Notes

(i)

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

(ii)

Structural borrowings of shareholder-financed businesses exclude borrowings to support short-term fixed income securities programmes, non-recourse borrowings of investment subsidiaries of shareholder-financed businesses and other borrowings of shareholder-financed businesses. Cash flows in respect of these borrowings are included within cash flows from operating activities. The changes in the carrying value of the structural borrowings of shareholder-financed businesses during 2018 are analysed as follows:

| | Cash movements £m | | | | Non-cash movements £m | | |
|------|------------------------------|---------------|--------------------|-----------------------|---------------------------|-----------------|------------------------|
| | Balance at beginning of year | Issue of debt | Redemption of debt | Modification of debt* | Foreign exchange movement | Other movements | Balance at end of year |
| 2018 | 6,280 | 1,630 | (434) | (33) | 210 | 11 | 7,664 |
| 2017 | 6,798 | 565 | (751) | – | (341) | 9 | 6,280 |

*

The amount in 2018 relates to fees paid to bondholders who participated in the voting process in respect of certain modifications to the terms and conditions of the senior debt. Other than these fees, the modification did not result in an adjustment to the carrying value of the senior debt.

(iii)

Interest paid on structural borrowings of with-profits businesses relates solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds, which contribute to the solvency base of the Scottish Amicable Insurance Fund

(SAIF), a ring-fenced sub-fund of the UK with-profits fund. These bonds were redeemed in full on 30 June 2018. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

(iv)

Tax paid includes £134 million (2017: £298 million) paid on profits taxable at policyholder rather than shareholder rates.

(v)

Cash flows arising from the 'acquisition of businesses and intangibles' and 'sale of businesses' include amounts paid for distribution rights and cash flows arising from the acquisitions and disposals of businesses (including subsidiaries acquired and disposed of by with-profits funds for investment purposes).

International Financial Reporting Standards (IFRS) Basis Results

Notes

A

Background

A1

Basis of preparation and exchange rates

These statements have been prepared in accordance with IFRS Standards as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU) as required by EU law (IAS Regulation EC1606/2032). EU-endorsed IFRS Standards may differ from IFRS Standards issued by the IASB if, at any point in time, new or amended IFRS Standards have not been endorsed by the EU. At 31 December 2018, there were no unendorsed standards effective for the two years ended 31 December 2018 which impact the consolidated financial information of the Group. There were no differences between IFRS Standards endorsed by the EU and IFRS Standards issued by the IASB in terms of their application to the Group.

The Group IFRS accounting policies are the same as those applied for the year ended 31 December 2017 with the exception of the adoption of the new and amended accounting standards as described in note A2.

Exchange rates

The exchange rates applied for balances and transactions in currency other than the presentational currency of the Group, pounds sterling (GBP), were:

| | Closing rate at 31 Dec 2018 | Average rate for 2018 | Closing rate at 31 Dec 2017 | Average rate for 2017 |
|-------------------|-----------------------------------|-----------------------------|-----------------------------------|-----------------------------|
| Local currency: £ | | | | |
| Hong Kong | 9.97 | 10.46 | 10.57 | 10.04 |
| Indonesia | 18,314.37 | 18,987.65 | 18,353.44 | 17,249.38 |
| Malaysia | 5.26 | 5.38 | 5.47 | 5.54 |
| Singapore | 1.74 | 1.80 | 1.81 | 1.78 |
| China | 8.74 | 8.82 | 8.81 | 8.71 |
| India | 88.92 | 91.25 | 86.34 | 83.90 |
| Vietnam | 29,541.15 | 30,732.53 | 30,719.60 | 29,279.71 |
| Thailand | 41.47 | 43.13 | 44.09 | 43.71 |
| US | 1.27 | 1.34 | 1.35 | 1.29 |

Certain notes to the financial statements present 2017 comparative information at constant exchange rates (CER), in addition to the reporting at actual exchange rates (AER) used throughout the consolidated financial statements. AER are actual historical exchange rates for the specific accounting period, being the average rates over the period for the income statement and the closing rates for the balance sheet at the balance sheet date. CER results are calculated by translating prior period results using the current period foreign exchange rate, ie current period average rates for the income statement and current period closing rates for the balance sheet.

The financial information set out in this announcement does not constitute the Company's statutory accounts for the years ended 31 December 2018 or 2017 but is derived from those accounts. The auditors have reported on the 2018 statutory accounts. Statutory accounts for 2017 have been delivered to the registrar of companies, and those for 2018 will be delivered following the Company's Annual General Meeting. Their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

A2

New accounting pronouncements in 2018

IFRS 15, 'Revenue from Contracts with Customers'

The Group has adopted IFRS 15, 'Revenue from Contracts with Customers' from 1 January 2018. This standard provides a single framework to recognise revenue for contracts with different characteristics and overrides the revenue recognition requirements previously provided in other standards. The contracts excluded from the scope of this standard include:

- Lease contracts within the scope of IAS 17, 'Leases';
- Insurance contracts within the scope of IFRS 4, 'Insurance Contracts'; and
- Financial instruments within the scope of IAS 39, 'Financial Instruments'.

The main impacts of IFRS 15 for Prudential are to revenue recognition for asset management contracts and investment contracts that do not contain discretionary participating features but do include investment management services.

In accordance with the transition provisions in IFRS 15, the Group has adopted the standard using the full retrospective method for all periods presented. The only impact on the prior periods presented is a minor reclassification in the consolidated income statement to present certain expenses (such as rebates to clients of asset management fees) as a deduction against revenue. Revenue has been reduced by £234 million in 2018 (2017: £172 million) with a corresponding deduction in expenses.

IFRS 9, 'Financial Instruments' and amendments to IFRS 4, 'Insurance Contracts'

The IASB published a complete version of IFRS 9 in July 2014 with the exception of macro hedge accounting and the standard is mandatorily effective for annual periods beginning on or after 1 January 2018.

In September 2016, the IASB published amendments to IFRS 4, 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' to address the temporary consequences of the different effective dates of IFRS 9 and IFRS 17, 'Insurance Contracts'. The amendments include an optional temporary exemption from applying IFRS 9 and the associated amendments until IFRS 17 comes into effect in 2021. This temporary exemption is available to companies whose predominant activity is to issue insurance contracts based on meeting the eligibility criteria as at 31 December 2015 as set out in the amendments.

The Group met the eligibility criteria for temporary exemption under the amendments to IFRS 4 from applying IFRS 9 and has accordingly deferred the adoption of IFRS 9. See note A3.2 for further details on IFRS 9, including the disclosures associated with the temporary exemption.

In November 2018, the IASB tentatively decided that the effective date of IFRS 17 should be delayed by one year from periods ending on or after 1 January 2021 to 1 January 2022. The IASB also tentatively decided that IFRS 9 could be delayed for insurers by an additional year to keep the effective date of IFRS 9 and IFRS 17 aligned. These changes are yet to be finalised and the Group continues to monitor developments.

Other new accounting pronouncements

In addition to the above, the following new accounting pronouncements are also effective from 1 January 2018:

- IFRIC 22, ‘Foreign Currency Transactions and Advance Consideration’;
- Classification and measurement of share-based payment transactions (amendments to IFRS 2, ‘Share-based payment’);
- Transfers of Investment Property (amendments to IAS 40, ‘Investment property’); and
- Annual Improvements to IFRSs 2014–2016 Cycle.

These pronouncements have had no effect on the Group’s financial statements.

B

Earnings performance

B1

Analysis of performance by segment

B1.1

Segment results – profit before tax

| | Note | 2018 £m | 2017 £m | | 2018 vs 2017 % | |
|-------------------------------------|----------|---------|-----------|-----------|----------------|-----------|
| | | | AER | CER | AER | CER |
| | | | note (iv) | note (iv) | note (iv) | note (iv) |
| Asia: | | | | | | |
| Insurance operations | B3(i) | 1,982 | 1,799 | 1,727 | 10% | 15% |
| Asset management | | 182 | 176 | 171 | 3% | 6% |
| Total Asia | | 2,164 | 1,975 | 1,898 | 10% | 14% |
| US: | | | | | | |
| Jackson (US insurance operations) | | 1,911 | 2,214 | 2,137 | (14)% | (11)% |
| Asset management | | 8 | 10 | 9 | (20)% | (11)% |
| Total US | | 1,919 | 2,224 | 2,146 | (14)% | (11)% |
| UK and Europe: | | | | | | |
| UK and Europe insurance operations: | B3(iii) | | | | | |
| Long-term business | | 1,138 | 861 | 861 | 32% | 32% |
| General insurance commission | note (i) | 19 | 17 | 17 | 12% | 12% |

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| | | | | | | |
|--|------|--------|-----------|-----------|----------------|-----------|
| Total UK and Europe insurance operations | | 1,157 | 878 | 878 | 32% | 32% |
| UK and Europe asset managementnote (v) | B2 | 477 | 500 | 500 | (5)% | (5)% |
| Total UK and Europe | | 1,634 | 1,378 | 1,378 | 19% | 19% |
| Total segment profit | | 5,717 | 5,577 | 5,422 | 3% | 5% |
| Other income and expenditure: | | | | | | |
| Investment return and other income | | 52 | 11 | 11 | 373% | 373% |
| Interest payable on core structural borrowings | | (410) | (425) | (425) | 4% | 4% |
| Corporate expenditurenote (ii) | | (367) | (361) | (355) | (2)% | (3)% |
| Total other income and expenditure | | (725) | (775) | (769) | 6% | 6% |
| Restructuring costs | | (165) | (103) | (103) | (60)% | (60)% |
| Adjusted IFRS operating profit based on longer-term investment returns | | 4,827 | 4,699 | 4,550 | 3% | 6% |
| Short-term fluctuations in investment returns on shareholder-backed business | B1.2 | (558) | (1,563) | (1,514) | 64% | 63% |
| Amortisation of acquisition accounting adjustmentsnote (iii) | | (46) | (63) | (61) | 27% | 25% |
| (Loss) gain on disposal of businesses and corporate transactions | D1.1 | (588) | 223 | 218 | n/a | n/a |
| Profit before tax | | 3,635 | 3,296 | 3,193 | 10% | 14% |
| Tax charge attributable to shareholders' returns | B4 | (622) | (906) | (876) | 31% | 29% |
| Profit for the year | | 3,013 | 2,390 | 2,317 | 26% | 30% |
| Attributable to: | | | | | | |
| Equity holders of the Company | | 3,010 | 2,389 | 2,316 | 26% | 30% |
| Non-controlling interests | | 3 | 1 | 1 | 200% | 200% |
| | Note | 2018 | 2017 | | 2018 vs 2017 % | |
| | | | AER | CER | AER | CER |
| Basic earnings per share (in pence) | | | note (iv) | note (iv) | note (iv) | note (iv) |
| Based on adjusted IFRS operating profit based on longer-term investment returnsnote (vi) | B5 | 156.6p | 145.2p | 140.4p | 8% | 12% |
| Based on profit for the year | B5 | 116.9p | 93.1p | 90.0p | 26% | 30% |

Notes

(i)

The majority of the general insurance commission is not expected to recur in future years.

(ii)

Corporate expenditure as shown above is primarily for Group Head Office and Asia Regional Head Office.

(iii)

Amortisation of acquisition accounting adjustments principally relate to the REALIC business of Jackson which was acquired in 2012.

(iv)

For definitions of AER and CER refer to note A1. The difference between 'Profit for the year attributable to shareholders' in the prior year on an AER basis and a CER basis is £73 million, arising from the retranslation of the prior year results of the Group's foreign subsidiaries into GBP using the exchange rates applied to the equivalent current year results.

(v)

UK and Europe asset management adjusted IFRS operating profit based on longer-term investment returns:

| | 2018 £m | 2017 £m |
|-----------------------------|---------|---------|
| Asset management fee income | 1,098 | 1,027 |

| | | |
|---|-------|-------|
| Other income | 2 | 7 |
| Staff costs* | (384) | (400) |
| Other costs* | (270) | (202) |
| Underlying profit before performance-related fees | 446 | 432 |
| Share of associate results | 16 | 15 |
| Performance-related fees | 15 | 53 |
| Total UK and Europe asset management adjusted IFRS operating profit based on longer-term investment returns | 477 | 500 |

*
Staff and other costs include £27 million of charges incurred preparing for Brexit.

(vi)
Tax charges have been reflected as operating and non-operating in the same way as for the pre-tax items. Further details on tax charges are provided in note B4.

B1.2 Short-term fluctuations in investment returns on shareholder-backed business

| | 2018 £m | 2017 £m |
|--------------------------|---------|---------|
| Asia operations | (512) | (1) |
| US operations | (100) | (1,568) |
| UK and Europe operations | 34 | (14) |
| Other operations | 20 | 20 |
| Total | (558) | (1,563) |

(i)
Asia operations
In Asia, the negative short-term fluctuations of £(512) million (2017: negative £(1) million) principally reflect net value movements on assets and related liabilities following increases in bond yields and falls in equity markets during the year, especially in those countries where policyholder liabilities use a valuation interest rate which does not reflect all movements in interest rates in the period.

(ii)
US operations
The short-term fluctuations in investment returns for US insurance operations are reported net of the related charge for amortisation of deferred acquisition costs of £(114) million as shown in note C5.2(a) (2017: credit of £462 million) and comprise amounts in respect of the following items:

| | 2018 £m | 2017 £m |
|---------------------------|---------|---------|
| Net equity hedge | (58) | (1,490) |
| resultnote (a) | | |
| Other than equity-related | (64) | (36) |

derivativesnote

(b)

Debt

securitiesnote (31) (73)

(c)

Equity-type

investments:

actual less 38 12

longer-term

return

Other items 15 19

Total (100) (1,568)

Notes

(a)

Net equity hedge result

The net equity hedge result relates to the accounting effect of market movements on both the value of guarantees in Jackson's variable annuity and fixed index annuity products and on the related derivatives used to manage the exposures inherent in these guarantees. The level of fees recognised in non-operating profit is determined by reference to that allowed for within the reserving basis. The variable annuity guarantees are valued in accordance with either Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures (formerly FAS 157) or ASC Topic 944, Financial Services – Insurance (formerly SOP 03-01) depending on the type of guarantee. Both approaches require an entity to determine the total fee ('the fee assessment') that is expected to fund future projected benefit payments arising using the assumptions applicable for that method. The method under FAS 157 requires this fee assessment to be fixed at the time of issue. As the fees included within the initial fee assessment are earned, they are included in non-operating profit to match the corresponding movement in the guarantee liability. As the Group applies US GAAP for the measured value of the product guarantees this item also includes asymmetric impacts where the measurement bases of the liabilities and associated derivatives used to manage the Jackson annuity business differ as described in note B1.3(c) below.

The net equity hedge result therefore includes significant accounting mismatches and other factors that do not represent the economic result. These other factors include:

- The variable annuity guarantees and fixed index annuity embedded options being only partially fair valued under 'grandfathered' US GAAP as described in note B1.3(c);
- The interest rate exposure being managed through the other than equity-related derivative programme explained in note (b) below; and
- Jackson's management of its economic exposures for a number of other factors that are treated differently in the accounting frameworks such as future fees and assumed volatility levels.

The net equity hedge result (net of related DAC amortisation in accordance with the policy that DAC is amortised in line with emergence of margins) can be summarised as follows:

| | 2018 £m | 2017 £m |
|---|---------|---------|
| Fair value movements on equity hedge instruments* | 299 | (1,871) |
| Accounting value movements on the variable and fixed index annuity guarantee liabilities† | (894) | (99) |
| Fee assessments net of claim payments | 537 | 480 |
| Total | (58) | (1,490) |

*

Held to manage equity exposures of the variable annuity guarantees and fixed index annuity options.

†

The accounting value movements on the variable and fixed index annuity guarantee liabilities reflect the impact of market movements and changes in economic and actuarial assumptions. Actuarial assumptions include consideration of persistency, mortality and the expected utilisation of certain features attaching to variable annuity contracts. Assumptions are updated annually via a comparison to experience and after applying expert judgement for how experience may change in the future. Routine updates in 2018 reduced profit before tax (after allowing related changed to DAC amortisation) by £143 million (2017: £382 million).

(b)

Other than equity-related derivatives

The fluctuations for this item comprise the net effect of:

–

Fair value movements on free-standing, other than equity-related derivatives;

–

Fair value movements on the Guaranteed Minimum Income Benefit (GMIB) reinsurance asset that are not matched by movements in the underlying GMIB liability, which is not fair valued as explained in note B1.3; and

–

Related amortisation of DAC.

The free-standing, other than equity-related derivatives are held to manage interest rate exposures and durations within the general account and the variable annuity guarantees and fixed index annuity embedded options described in note (a) above. Accounting mismatches arise because of differences between the measurement basis and presentation of the derivatives, which are fair valued with movements recorded in the income statement, and the exposures they are intended to manage.

(c)

Short-term fluctuations related to debt securities

| | 2018 £m | 2017 £m |
|---|---------|---------|
| (Charges) credits in the year: | | |
| Losses on sales of impaired and deteriorating bonds | (4) | (3) |
| Bond write-downs | (4) | (2) |
| Recoveries/reversals | 19 | 10 |
| Total credits in the year | 11 | 5 |
| Risk margin allowance deducted from adjusted IFRS operating profit based on longer-term investment returns* | 77 | 86 |
| | 88 | 91 |
| Interest-related realised (losses) gains: | | |
| Losses arising in the year | (8) | (43) |
| Less: Amortisation of gains and losses arising in current and prior years to adjusted IFRS operating profit based on longer-term investment returns | (116) | (140) |
| | (124) | (183) |
| Related amortisation of deferred acquisition costs | 5 | 19 |
| Total short-term fluctuations related to debt securities | (31) | (73) |

*

The debt securities of Jackson are held in the general account of the business. Realised gains and losses are recorded in the income statement with normalised returns included in adjusted IFRS operating profit based on longer-term investment returns with variations from year to year included in the short-term fluctuations category. The risk margin

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reserve charge for longer-term credit-related losses included in adjusted IFRS operating profit based on longer-term investment returns of Jackson for 2018 is based on an average annual risk margin reserve of 18 basis points (2017: 21 basis points) on average book values of US\$57.1 billion (2017: US\$55.3 billion) as shown below:

Moody's rating category (or equivalent under NAIC ratings of mortgage-backed securities)

| | 2018 | | Annual | | 2017 | | Annual | |
|--|--------------------|------|---------------|------|--------------------|------|---------------|------|
| | Average book value | RMR | expected loss | loss | Average book value | RMR | expected loss | loss |
| | US\$m | % | US\$m | £m | US\$m | % | US\$m | £m |
| A3 or higher | 29,982 | 0.10 | (31) | (23) | 27,277 | 0.12 | (33) | (25) |
| Baa1, 2 or 3 | 25,814 | 0.21 | (55) | (40) | 26,626 | 0.22 | (58) | (45) |
| Ba1, 2 or 3 | 1,042 | 0.98 | (10) | (8) | 1,046 | 1.03 | (11) | (8) |
| B1, 2 or 3 | 289 | 2.64 | (8) | (6) | 318 | 2.70 | (9) | (7) |
| Below B3 | 11 | 3.69 | – | – | 23 | 3.78 | (1) | (1) |
| Total | 57,138 | 0.18 | (104) | (77) | 55,290 | 0.21 | (112) | (86) |
| Related amortisation of deferred acquisition costs (see below) | | | 22 | 15 | | | 21 | 15 |
| Risk margin reserve charge to adjusted IFRS operating profit for longer-term credit-related losses | | | (82) | (62) | | | (91) | (71) |

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

In addition to the accounting for realised gains and losses described above for Jackson general account debt securities, included within the statement of other comprehensive income is a pre-tax charge of £(1,371) million for net unrealised losses on debt securities classified as available-for-sale net of related amortisation of deferred acquisition costs (2017: credit of £541 million). Temporary market value movements do not reflect defaults or impairments. Additional details of the movement in the value of the Jackson portfolio are included in note C3.2(b).

(iii)
UK and Europe operations
The positive short-term fluctuations in investment returns for the UK and Europe operations of £34 million (2017: negative £14 million) mainly arises from unrealised gains on equity options held to hedge the value of future shareholder transfers from the with-profits fund partially offset by losses on corporate bonds backing capital to support the remaining annuity business, given the increase in interest rates and credit spreads in 2018.

(iv)
Other operations
The positive short-term fluctuations in investment returns for other operations of £20 million (2017: positive £20 million) include unrealised value movements on financial instruments held outside of the main life operations.

B1.3 Determining operating segments and performance measure of operating segments

Operating segments

The Group's operating segments for financial reporting are defined and presented in accordance with IFRS 8, 'Operating Segments', on the basis of the management reporting structure and its financial management information.

Under the Group's management and reporting structure its chief operating decision maker is the Group Executive Committee (GEC). In the management structure, responsibility is delegated to the Chief Executive Officers of Prudential Corporation Asia, the North American Business Unit and M&GPrudential for the day-to-day management of their business units (within the framework set out in the Group Governance Manual). Financial management information used by the GEC aligns with these three business segments. These operating segments derive revenue from both long-term insurance and asset management activities.

Operations which do not form part of any business unit are reported as 'Unallocated to a segment'. These include Group Head Office and Asia Regional Head Office costs. Prudential Capital and Africa operations do not form part of any operating segment under the structure, and their assets and liabilities and profit or loss before tax are not material to the overall financial position of the Group. Prudential Capital and Africa operations are therefore reported as 'Unallocated to a segment'.

Performance measure

The performance measure of operating segments utilised by the Company is adjusted IFRS operating profit attributable to shareholders based on longer-term investment returns, as described below. This measurement basis distinguishes adjusted IFRS operating profit based on longer-term investment returns from other constituents of the total profit as follows:

- Short-term fluctuations in investment returns on shareholder-backed business. This includes the impact of short-term market effects on the carrying value of Jackson's guarantee liabilities and related derivatives as explained below;
- Amortisation of acquisition accounting adjustments arising on the purchase of business. This comprises principally the charge for the adjustments arising on the purchase of REALIC in 2012; and
- Gain or loss on corporate transactions, such as disposals undertaken in the year.

Determination of adjusted IFRS operating profit based on longer-term investment returns for investment and liability movements:

(a)
General principles

(i)
UK-style with-profits business

The adjusted IFRS operating profit based on longer-term investment returns reflects the statutory transfer gross of attributable tax. Value movements in the underlying assets of the with-profits funds do not affect directly the determination of adjusted IFRS operating profit based on longer-term investment returns.

(ii)
Unit-linked business

The policyholder unit liabilities are directly reflective of the underlying asset value movements. Accordingly, the adjusted IFRS operating profit based on longer-term investment returns reflect the current period value movements in both the unit liabilities and the backing assets.

(iii)

US variable annuity and fixed index annuity business

This business has guarantee liabilities which are measured on a combination of fair value and other US GAAP derived principles. These liabilities are subject to an extensive derivative programme to manage equity and interest rate exposures whose fair value movements pass through the income statement each period. The principles for determination of the adjusted IFRS operating profit based on longer-term investment returns and short-term fluctuations are as discussed in section (c) below.

(iv)

Business where policyholder liabilities are sensitive to market conditions

Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between business units depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities is broadly equivalent in the income statement, and adjusted IFRS operating profit based on longer-term investment returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate to longer-term market conditions and short-term effects.

However, movements in liabilities for some types of business do require bifurcation to ensure that at the net level (ie after allocated investment return and charge for policyholder benefits) the adjusted IFRS operating profit based on longer-term investment returns reflects longer-term market returns.

Examples of where such bifurcation is necessary are in Hong Kong and for UK shareholder-backed annuity business, as explained in sections b(i) and d(i), respectively. For other types of Asia's non-participating business, expected longer-term investment returns are used to determine the movement in policyholder liabilities for determining adjusted IFRS operating profit based on longer-term investment returns.

(v)

Other shareholder-financed business

For long-term insurance business, where assets and liabilities are held for the long term, the accounting basis for insurance liabilities under current IFRS can lead to profits that include the effects of short-term fluctuations in market conditions, which may not be representative of trends in underlying performance. Therefore, the following key elements are applied to the results of the Group's shareholder-financed businesses to determine adjusted IFRS operating profit based on longer-term investment returns.

Except in the case of assets backing liabilities which are directly matched (such as unit-linked business) or closely correlated with value movements (as discussed below) adjusted IFRS operating profit based on longer-term investment returns for shareholder-financed business is determined on the basis of expected longer-term investment returns. Longer-term investment returns comprise actual income receivable for the period (interest/dividend income) and for both debt and equity-type securities longer-term capital returns.

Debt securities and loans

In principle, for debt securities and loans, the longer-term capital returns comprise two elements:

–

Risk margin reserve based charge for the expected level of defaults for the period, which is determined by reference to the credit quality of the portfolio. The difference between impairment losses in the reporting period and the risk margin reserve charge to the adjusted IFRS operating profit based on longer-term investment returns is reflected in short-term fluctuations in investment returns; and

–

The amortisation of interest-related realised gains and losses to adjusted IFRS operating profit based on longer-term investment returns to the date when sold bonds would have otherwise matured.

At 31 December 2018, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £629 million (2017: £855 million).

Equity-type securities

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

Derivative value movements

Generally, derivative value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns. The exception is where the derivative value movements broadly offset changes in the accounting value of other assets and liabilities included in adjusted IFRS operating profit based on longer-term investment returns. The principal example of derivatives whose value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns arises in Jackson, as discussed below in section (c).

(b)

Asia insurance operations

(i)

Business where policyholder liabilities are sensitive to market conditions

For certain Asia non-participating business, for example in Hong Kong, the economic features are more akin to asset management products with policyholder liabilities reflecting asset shares over the contract term. Consequently, for these products, the charge for policyholder benefits in the adjusted IFRS operating profit based on longer-term investment returns reflects the asset share feature rather than volatile movements that would otherwise be reflected if the local regulatory basis (also applied for IFRS basis) was used.

For certain other types of non-participating business expected longer-term investment returns are used to determine the movement in policyholder liabilities for determining adjusted IFRS operating profit based on longer-term investment returns.

(ii)

Other Asia shareholder-financed business

Debt securities

For this business, the realised gains and losses are principally interest related. Accordingly, all realised gains and losses to date for these operations are amortised over the period to the date those securities would otherwise have matured, with no explicit risk margin reserve charge.

Equity-type securities

For Asia insurance operations, investments in equity securities held for non-linked shareholder-backed business amounted to £2,146 million as at 31 December 2018 (31 December 2017: £1,759 million). The rates of return applied in 2018 ranged from 5.3 per cent to 17.6 per cent (2017: 4.3 per cent to 17.2 per cent) with the rates applied varying by business unit. These rates are broadly stable from period to period but may be different between countries reflecting, for example, differing expectations of inflation in each business unit. The assumptions are for the returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

The longer-term investment returns for the Asia insurance joint ventures accounted for using the equity method are determined on a similar basis as the other Asia insurance operations described above.

(c)

US insurance operations

(i)

Separate account business

For such business the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly, the adjusted IFRS operating profit based on longer-term investment returns reflect the current period value movements in unit liabilities and the backing assets.

(ii)

US variable and fixed index annuity business

The following value movements for Jackson's variable and fixed index annuity business are excluded from adjusted IFRS operating profit based on longer-term investment returns. See note B1.2 note (ii):

–

Fair value movements for equity-based derivatives;

–

Fair value movements for guaranteed benefit options for the 'not for life' portion of Guaranteed Minimum Withdrawal Benefit (GMWB) and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance (see below);

–

Movements in the accounts carrying value of Guaranteed Minimum Death Benefit (GMDB), GMIB and the 'for life' portion of GMWB liabilities, (see below) for which, under the 'grandfathered' US GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements (ie they are relatively insensitive to the effect of current period equity market and interest rate changes);

–

A portion of the fee assessments as well as claim payments, in respect of guarantee liabilities; and

–

Related amortisation of deferred acquisition costs for each of the above items.

Guaranteed benefit options for the 'not for life' portion of GMWB and equity index options for the fixed index annuity business

The 'not for life' portion of GMWB guaranteed benefit option liabilities is measured under the US GAAP basis applied for IFRS in a manner consistent with IAS 39 under which the projected future growth rate of the account balance is based on current swap rates (rather than expected rates of return) with only a portion of the expected future guarantee fees included. Reserve value movements on these liabilities are sensitive to changes to levels of equity markets, implied volatility and interest rates. The equity index option for fixed index annuity business is measured under the US GAAP basis applied for IFRS in a manner consistent with IAS 39 under which the projected future growth is based on current swap rates.

Guaranteed benefit option for variable annuity guarantee minimum income benefit

The GMIB liability, which is substantially reinsured, subject to a deductible and annual claim limits, is accounted for using 'grandfathered' US GAAP. This accounting basis substantially does not recognise the effects of market movements. The corresponding reinsurance asset is measured under the 'grandfathered' US GAAP basis applied for IFRS in a manner consistent with IAS 39, 'Financial Instruments: Recognition and Measurement', and the asset is therefore recognised at fair value. As the GMIB is economically reinsured, the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

(iii)

Other derivative value movements

The principal example of non-equity based derivatives (for example, interest rate swaps and swaptions) whose value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns, arises in Jackson. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson's bond portfolio (for which value movements are booked in the statement of other comprehensive income rather than the income statement), product liabilities (for which US GAAP accounting as 'grandfathered' under IFRS 4 does not fully reflect the economic features being hedged), and the interest rate exposure attaching to equity-based product options.

(iv)

Other US shareholder-financed business

Debt securities

The distinction between impairment losses and interest-related realised gains and losses is of particular relevance to Jackson. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) to determine the average annual risk margin reserve to apply to debt securities held to back general account business. Debt securities held to back separate account and reinsurance funds withheld are not subject to risk margin reserve charge. Further details of the risk margin reserve charge, as well as the amortisation of interest-related realised gains and losses, for Jackson are shown in note B1.2 note (ii)(c).

Equity-type securities

As at 31 December 2018, the equity-type securities for US insurance non-separate account operations amounted to £1,359 million (31 December 2017: £946 million). For these operations, the longer-term rates of return for income and capital applied in the years indicated, which reflect the combination of the average risk-free rates over the year and appropriate risk premiums are as follows:

| | 2018 | 2017 |
|---|--------------|--------------|
| Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds | 6.7% to 7.2% | 6.1% to 6.5% |
| Other equity-type securities such as investments in limited partnerships and private equity funds | 8.7% to 9.2% | 8.1% to 8.5% |

(d)

UK and Europe insurance operations

(i)

Shareholder-backed annuity business

For this 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 'adjusted IFRS operating profit based on longer-term investment returns'. Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

The adjusted IFRS operating profit based on longer-term investment returns reflects the impact of value movements on policyholder liabilities for shareholder-backed annuity business within The Prudential Assurance Company Limited (PAC) after adjustments to allocate the following elements of the movement to the category of 'short-term fluctuations in investment returns':

–

The impact on credit risk provisioning of actual upgrades and downgrades during the period;

–

Credit experience compared with assumptions; and

–
Short-term value movements on assets backing the capital of the business.

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Positive or negative experience compared with assumptions is included within short-term fluctuations in investment returns without further adjustment. The effects of other changes to credit risk provisioning are included in the adjusted IFRS operating profit based on longer-term investment returns, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

(ii)

Non-linked shareholder-financed business

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

(e)

Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply and therefore the adjusted IFRS operating profit based on longer-term investment returns is not determined on the basis described above. Instead, realised gains and losses are generally included in adjusted IFRS operating profit based on longer-term investment returns with temporary unrealised gains and losses being included in short-term fluctuations. In some instances, realised gains and losses on derivatives and other financial instruments are amortised to adjusted IFRS operating profit based on longer-term investment returns over a time period that reflects the underlying economic substance of the arrangements.

B2

Acquisition costs and other expenditure

| | 2018 £m | 2017 £m |
|---|---------|---------|
| Acquisition costs incurred for insurance policies | (3,438) | (3,712) |
| Acquisition costs deferred less amortisation of acquisition costs | 59 | 911 |
| Administration costs and other expenditure* | (5,380) | (6,208) |
| Movements in amounts attributable to external unit holders of consolidated investment funds | (96) | (984) |
| Total acquisition costs and other expenditure | (8,855) | (9,993) |

*

Following the adoption of IFRS 15, the 2017 comparative results have been re-presented as described in note A2. The 2018 administration costs and other expenditure includes a credit of £0.4 billion for the negative ceding commissions arising from the group payout annuity business reinsurance agreement entered into by Jackson with John Hancock Life during the year.

B3

Effect of changes and other accounting matters on insurance assets and liabilities

The following matters are relevant to the determination of the 2018 results:

(i)

Asia insurance operations

In 2018, the adjusted IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £94 million (2017: £75 million) representing a small number of items that are not expected to

reoccur, including the non-recurring impact of a refinement to the run-off of the allowance for prudence within technical provisions within Singapore.

(ii)

US insurance operations

Changes in the policyholder liabilities held for variable and fixed index annuity guarantees are reported as part of non-operating profit and are as described in note B1.2.

(iii)

UK and Europe insurance operations

Allowance for credit risk

For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowance made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest for discounting projected future annuity payments to policyholders that would have otherwise applied. The credit risk allowance comprises an amount for long-term best estimate defaults and additional provisions for credit risk premium, the cost of downgrades and short-term defaults.

The IFRS credit risk allowance made for the UK shareholder-backed fixed and linked annuity business equated to 40 basis points at 31 December 2018 (31 December 2017: 42 basis points). The allowance represented 22 per cent of the bond spread over swap rates (31 December 2017: 28 per cent).

The reserves for credit risk allowance at 31 December 2018 for the UK shareholder-backed business were £0.9 billion (31 December 2017: £1.6 billion). The 2018 credit risk allowance information is after reflecting the impact of the reinsurance of £12.0 billion of the UK shareholder-backed annuity portfolio to Rothesay Life entered into in March 2018. See note D1.1 for further details.

Other assumption changes

For the shareholder-backed business, in addition to the movement in the credit risk allowance discussed above, the net effect of routine changes to assumptions in 2018 was a credit of £437 million (2017: credit of £173 million). This included, among other items, a benefit to adjusted IFRS operating profit based on longer-term investment returns of £441 million (2017: £204 million), relating to changes to annuitant mortality assumptions to reflect current mortality experience, which has shown a slowdown in life expectancy improvements in recent periods, and the adoption of the Continuous Mortality Investigation (CMI) 2016 model (2017: adoption of 2015 model).

Longevity reinsurance and other management actions

Aside from the aforementioned reinsurance agreement with Rothesay Life, no new longevity reinsurance transactions were undertaken in 2018 (2017: longevity reinsurance transactions covering £0.6 billion of IFRS annuity liabilities contributed £31 million to profit). Other management actions generated profits of £58 million (2017: £245 million).

Review of past annuity sales

Prudential has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review is examining whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. A gross provision of £400 million, before costs incurred, was established at 31 December 2017 to cover the costs of undertaking the review and any related redress and following a reassessment, no change has been made in 2018. The majority of the provision will be utilised in 2019. The ultimate amount that will be expended by the Group on the review will remain uncertain until the project is completed. If the population subject to redress increased or decreased by 10 per cent, then the provision would be expected to increase or decrease by circa 7 per cent accordingly. Additionally, in 2018, the Group agreed with its professional indemnity insurers that they will meet £166 million of the Group's claims costs, which will be paid as the Group incurs costs/redress. This has been recognised on

the Group's balance sheet within 'Other debtors' at 31 December 2018.

B4

Tax charge

(a)

Total tax charge by nature of expense

The total tax charge in the income statement is as follows:

| Tax charge | 2018 £m | | 2017 £m | |
|--|-------------|--------------|---------|---------|
| | Current tax | Deferred tax | Total | Total |
| Attributable to shareholders: | | | | |
| Asia operations | (199) | (78) | (277) | (253) |
| US operations | (87) | (168) | (255) | (508) |
| UK and Europe | (255) | 39 | (216) | (267) |
| Other operations | 125 | 1 | 126 | 122 |
| Tax charge attributable to shareholders' returns | (416) | (206) | (622) | (906) |
| Attributable to policyholders: | | | | |
| Asia operations | (92) | 12 | (80) | (249) |
| UK and Europe | (188) | 594 | 406 | (425) |
| Tax (charge) credit attributable to policyholders' returns | (280) | 606 | 326 | (674) |
| Total tax charge | (696) | 400 | (296) | (1,580) |

The principal reason for the decrease in the tax charge attributable to shareholders' returns is the inclusion in 2017 of a £445 million deferred tax charge arising on the remeasurement of the US net deferred tax assets from 35 per cent to 21 per cent following the enactment of the US tax reform package, the Tax Cuts and Jobs Act. The movement from a charge of £674 million to a credit of £326 million in the tax charge attributable to policyholders' returns mainly reflects a decrease in the deferred tax liabilities on unrealised gains on investments in the with-profits funds of the UK and Europe and of Asia compared to 2017.

The reconciliation of the expected to actual tax charge attributable to shareholders is provided in (b) below. The tax credit attributable to policyholders of £326 million above is equal to the loss before tax attributable to policyholders of £326 million. This is the result of accounting for policyholder income after the deduction of expenses and movement on unallocated surpluses and on an after-tax basis.

In 2018, a tax charge of £270 million (2017: charge of £93 million) has been taken through other comprehensive income.

(b)

Reconciliation of shareholder effective tax rate

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In the reconciliation below, the expected tax rates reflect the corporation tax rates that are expected to apply to the taxable profit of the relevant business. Where there are profits of more than one jurisdiction the expected tax rates reflect the corporation tax rates weighted by reference to the amount of profit contributing to the aggregate business result.

| | 2018 £m | | | | Total attributable to shareholders | Percentage impact on ETR |
|---|-----------------|------------------------|---------------|-------------------|------------------------------------|--------------------------|
| | Asia operations | US operations note (i) | UK and Europe | Other* operations | | |
| Adjusted IFRS operating profit (loss) based on longer-term investment returns | 2,164 | 1,919 | 1,634 | (890) | 4,827 | |
| Non-operating loss | (527) | (180) | (474) | (11) | (1,192) | |
| Profit (loss) before tax | 1,637 | 1,739 | 1,160 | (901) | 3,635 | |
| Expected tax rate | 22% | 21% | 19% | 19% | 21% | |
| Tax at the expected rate | 360 | 365 | 220 | (171) | 774 | 21.3% |
| Effects of recurring tax reconciliation items: | | | | | | |
| Income not taxable or taxable at concessionary rates | (34) | (17) | (6) | (2) | (59) | (1.6)% |
| Deductions not allowable for tax purposes | 39 | 3 | 15 | 10 | 67 | 1.8% |
| Items related to taxation of life insurance businesses note (ii) | (13) | (83) | (2) | – | (98) | (2.7)% |
| Deferred tax adjustments | (11) | – | 2 | (30) | (39) | (1.1)% |
| Effect of results of joint ventures and associates note (iii) | (63) | – | (3) | 2 | (64) | (1.8)% |
| Irrecoverable withholding taxes note (iv) | – | – | – | 47 | 47 | 1.3% |
| Other | (3) | – | 3 | 3 | 3 | 0.1% |
| Total | (85) | (97) | 9 | 30 | (143) | (4.0)% |
| Effects of non-recurring tax reconciliation items: | | | | | | |
| Adjustments to tax charge in relation to prior years | – | (17) | (11) | 14 | (14) | (0.4)% |
| Movements in provisions for open tax matters note (v) | 2 | 4 | (2) | 1 | 5 | 0.2% |
| Total | 2 | (13) | (13) | 15 | (9) | (0.2)% |
| Total actual tax charge (credit) | 277 | 255 | 216 | (126) | 622 | 17.1% |
| Analysed into: | | | | | | |
| Tax on adjusted IFRS operating profit based on longer-term investment returns | 308 | 301 | 313 | (130) | 792 | |
| Tax on non-operating profit | (31) | (46) | (97) | 4 | (170) | |
| Actual tax rate: | | | | | | |
| Adjusted IFRS operating profit based on longer-term investment returns: | 14% | 16% | 19% | 15% | 16% | |

| | | | | | |
|---|-----|-----|-----|-----|-----|
| Including non-recurring tax reconciling items | | | | | |
| Excluding non-recurring tax reconciling items | 14% | 16% | 20% | 16% | 16% |
| Total profit | 17% | 15% | 19% | 14% | 17% |

*

Other operations include restructuring costs.

Notes

(i)

Impact of US tax reform

The 2018 tax charge for US operations reflects the full impact of the US tax reform package, the Tax Cuts and Jobs Act, which was enacted in December 2017 and took effect from 1 January 2018. The expected tax rate of 21 per cent reflects the reduced US corporate income tax rate compared to 35 per cent for 2017. The benefit of the dividend received deduction (shown in Items related to the taxation of life insurance businesses) is lower in 2018 than 2017 reflecting the changes to how this deduction is computed. In 2017, the reduction in the US corporate income tax rate gave rise to a £445 million unfavourable reconciling item in US operations relating to the remeasurement of the net deferred tax asset attributable to shareholders and a £134 million benefit recognised in other comprehensive income.

(ii)

Items related to taxation of life insurance businesses

The £83 million (2017: £238 million) reconciling item in US operations reflects the impact of the dividend received deduction on the taxation of profits from variable annuity business. The principal reason for the reduction in the Asia operations reconciling items from £92 million at 2017 to £13 million at 2018 reflects non-operating investment losses in Hong Kong which do not attract tax relief offsetting the benefit of operating profits due to the taxable profit being computed as 5 per cent of net insurance premiums.

(iii)

Effects of results of joint ventures and associates

Profit before tax includes Prudential's share of profits after tax from the joint ventures and associates. Therefore, the actual tax charge does not include tax arising from profit or loss of joint ventures and associates and is reflected as a reconciling item in the table above.

(iv)

Irrecoverable withholding taxes

The £47 million (2017: £54 million) adverse reconciling items reflects local withholding taxes on dividends paid by certain non-UK subsidiaries, principally Indonesia, to the UK. The dividends are exempt from UK tax and consequently the withholding tax cannot be offset against UK tax payments.

(v)

Movements in provisions for open tax matters

The complexity of the tax laws and regulations that relate to our businesses means that from time to time we may disagree with tax authorities on the technical interpretation of a particular area of tax law. This uncertainty means that in the normal course of business the Group will have matters where, upon ultimate resolution of the uncertainty, the amount of profit subject to tax may be greater than the amounts reflected in the Group's submitted tax returns. The statement of financial position contains the following provisions in relation to open tax matters:

| | |
|--|-------|
| | £m |
| At 31 December 2017 | (139) |
| Movements in the current period included in: | |
| Tax charge attributable to shareholders | (5) |

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Other movements* (5)
 At 31 December 2018 (149)

*

Other movements include interest arising on open tax matters and amounts included in the Group's share of profits from joint ventures and associates, net of related tax.

| | 2017 £m | | | | Total attributable to shareholders | Percentage impact on ETR |
|---|-----------------|---------------|---------------|-------------------|------------------------------------|--------------------------|
| | Asia operations | US operations | UK and Europe | Other operations* | | |
| Adjusted IFRS operating profit (loss) based on longer-term investment returns | 1,975 | 2,224 | 1,378 | (878) | 4,699 | |
| Non-operating profit (loss) | 53 | (1,462) | (14) | 20 | (1,403) | |
| Profit (loss) before tax | 2,028 | 762 | 1,364 | (858) | 3,296 | |
| Expected tax rate | 21% | 35% | 19% | 19% | 24% | |
| Tax at the expected rate | 426 | 267 | 259 | (163) | 789 | 23.9% |
| Effects of recurring tax reconciliation items: | | | | | | |
| Income not taxable or taxable at concessionary rates | (64) | (11) | (2) | (14) | (91) | (2.8)% |
| Deductions not allowable for tax purposes | 26 | 6 | 13 | 10 | 55 | 1.7% |
| Items related to taxation of life insurance businesses | (92) | (238) | (2) | - | (332) | (10.1)% |
| Deferred tax adjustments | 11 | 17 | (1) | (5) | 22 | 0.7% |
| Effect of results of joint ventures and associates | (52) | - | (3) | - | (55) | (1.7)% |
| Irrecoverable withholding taxes | - | - | - | 54 | 54 | 1.6% |
| Other | (10) | - | 6 | (1) | (5) | (0.1)% |
| Total | (181) | (226) | 11 | 44 | (352) | (10.7)% |
| Effects of non-recurring tax reconciliation items: | | | | | | |
| Adjustments to tax charge in relation to prior years | (3) | (15) | (3) | (3) | (24) | (0.7)% |
| Movements in provisions for open tax matters | 19 | 25 | - | - | 44 | 1.3% |
| Impact of US tax reform | - | 445 | - | - | 445 | 13.5% |
| Adjustments in relation to business disposals | (8) | 12 | - | - | 4 | 0.1% |
| Total | 8 | 467 | (3) | (3) | 469 | 14.2% |
| Total actual tax charge (credit) | 253 | 508 | 267 | (122) | 906 | 27.4% |
| Analysed into: | | | | | | |
| Tax on adjusted IFRS operating profit based on longer-term investment returns | 276 | 548 | 268 | (121) | 971 | |
| Tax on non-operating profit | (23) | (40) | (1) | (1) | (65) | |
| Actual tax rate: | | | | | | |

Adjusted IFRS operating profit based on longer-term investment returns:

| | | | | | |
|---|-----|-----|-----|-----|-----|
| Including non-recurring tax reconciling items | 14% | 25% | 19% | 14% | 21% |
| Excluding non-recurring tax reconciling items | 13% | 24% | 20% | 13% | 20% |
| Total profit | 12% | 67% | 20% | 14% | 27% |

*

Other operations include restructuring costs.

B5

Earnings per share

| | 2018 | | | Net of tax and non-controlling interests £m | Basic earnings per share Pence | Diluted earnings per share Pence | |
|---|------------|-------|---------------------------|--|-----------------------------------|-------------------------------------|---------|
| | Before tax | Tax | Non-controlling interests | | | | |
| | £m | £m | £m | | | | |
| Based on adjusted IFRS operating profit based on longer-term investment returns | Note B1.1 | 4,827 | (792) | (3) | 4,032 | 156.6p | 156.5p |
| Short-term fluctuations in investment returns on shareholder-backed business | B1.2 | (558) | 53 | – | (505) | (19.7)p | (19.7)p |
| Amortisation of acquisition accounting adjustments | | (46) | 9 | – | (37) | (1.4)p | (1.4)p |
| Loss on disposal of businesses and corporate transactions | D1.1 | (588) | 108 | – | (480) | (18.6)p | (18.6)p |
| Based on profit for the year | | 3,635 | (622) | (3) | 3,010 | 116.9p | 116.8p |
| | 2017 | | | Net of tax and non-controlling interests £m | Basic earnings per share Pence | Diluted earnings per share Pence | |
| | Before tax | Tax | Non-controlling interests | | | | |
| | £m | £m | £m | | | | |
| | Note B1.1 | 4,699 | (971) | (1) | 3,727 | 145.2p | 145.1p |

| | | | | | | | |
|---|------|---------|-------|-----|-------|---------|---------|
| Based on adjusted IFRS operating profit based on longer-term investment returns | | | | | | | |
| Short-term fluctuations in investment returns on shareholder-backed business | B1.2 | (1,563) | 572 | – | (991) | (38.6)p | (38.6)p |
| Amortisation of acquisition accounting adjustments | | (63) | 20 | – | (43) | (1.7)p | (1.7)p |
| Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income | | 61 | – | – | 61 | 2.4p | 2.4p |
| Profit attaching to the disposal of businesses | D1.1 | 162 | (82) | – | 80 | 3.1p | 3.1p |
| Impact of US tax reform | B4 | – | (445) | – | (445) | (17.3)p | (17.3)p |
| Based on profit for the year | | 3,296 | (906) | (1) | 2,389 | 93.1p | 93.0p |

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

The weighted average number of shares for calculating earnings per share, which excludes those held in employee share trusts and consolidated unit trusts and OEICs, is set out as below:

| | 2018 | 2017 |
|--|-------|-------|
| Weighted average number (in millions) of shares for calculation of: | | |
| Basic earnings per share | 2,575 | 2,567 |
| Shares under option at end of year | 5 | 6 |
| Number of shares that would have been issued at fair value on assumed option price | (4) | (5) |
| Diluted earnings per share | 2,576 | 2,568 |

B6

Dividends

| | 2018 | | 2017 | |
|---------------------------------------|-----------------|-----|-----------------|-----|
| | Pence per share | £m | Pence per share | £m |
| Dividends relating to reporting year: | | | | |
| First interim ordinary dividend | 15.67p | 406 | 14.50p | 375 |

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| | | | | |
|---|--------|-------|--------|-------|
| Second interim ordinary dividend | 33.68p | 873 | 32.50p | 841 |
| Total | 49.35p | 1,279 | 47.00p | 1,216 |
| Dividends paid in reporting year: | | | | |
| Current year first interim ordinary dividend | 15.67p | 404 | 14.50p | 373 |
| Second interim ordinary dividend for prior year | 32.50p | 840 | 30.57p | 786 |
| Total | 48.17p | 1,244 | 45.07p | 1,159 |

Dividend per share

For the year ended 31 December 2017 the second interim ordinary dividend of 32.50 pence per ordinary share was paid to eligible shareholders on 18 May 2018. The 2018 first interim ordinary dividend of 15.67 pence per ordinary share was paid to eligible shareholders on 27 September 2018.

The second interim ordinary dividend for the year ended 31 December 2018 of 33.68 pence per ordinary share will be paid on 17 May 2019 in sterling to shareholders on the UK register and the Irish branch register on 29 March 2019 (Record Date), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 24 May 2019. The second interim ordinary dividend will be paid on or about 24 May 2019 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte) Limited (CDP) at 5.00pm Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 12 March 2019. The exchange rate at which the dividend payable to the SG Shareholders will be translated into Singapore dollars, will be determined by CDP.

Shareholders on the UK register and Irish branch register are eligible to participate in a Dividend Reinvestment Plan.

C

Balance sheet notes

C1

Analysis of Group statement of financial position by segment

| | 31 Dec 2018 £m | | | | | | 31 Dec 2017 £m |
|--|----------------|-------|------------------|--|--|----------------|-------------------|
| | Asia | US | UK and Europe | Unallocated to a segment (central operations) | Elimination of intra- group debtors and creditors | Group total | Group total |
| By operating segment | Note C2.1 | C2.2 | C2.3 | note | | | |
| Assets | | | | | | | |
| Goodwill | C5.1 498 | – | 1,359 | – | – | 1,857 | 1,482 |
| Deferred acquisition costs and other intangible assets | C5.2 2,937 | 8,747 | 195 | 44 | – | 11,923 | 11,011 |
| Property, plant and equipment | 129 | 246 | 1,031 | 3 | – | 1,409 | 789 |
| Reinsurers' share of insurance contract liabilities | 2,777 | 6,662 | 2,812 | 2 | (1,109) | 11,144 | 9,673 |

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| | | | | | | | | |
|---|------|--------|---------|---------|---------|---------|---------|---------|
| Deferred tax assets | C8 | 119 | 2,295 | 126 | 55 | – | 2,595 | 2,627 |
| Current tax recoverable | | 26 | 311 | 244 | 118 | (81) | 618 | 613 |
| Accrued investment income | | 664 | 498 | 1,511 | 76 | – | 2,749 | 2,676 |
| Other debtors | | 2,978 | 238 | 4,189 | 1,968 | (5,285) | 4,088 | 2,963 |
| Investment properties | | 5 | 6 | 17,914 | – | – | 17,925 | 16,497 |
| Investment in joint ventures and associates accounted for using the equity method | | 991 | – | 742 | – | – | 1,733 | 1,416 |
| Loans | C3.3 | 1,377 | 11,066 | 5,567 | – | – | 18,010 | 17,042 |
| Equity securities and portfolio holdings in unit trusts | | 32,150 | 128,657 | 53,810 | 116 | – | 214,733 | 223,391 |
| Debt securities | C3.2 | 45,839 | 41,594 | 85,956 | 1,967 | – | 175,356 | 171,374 |
| Derivative assets | | 296 | 574 | 2,513 | 111 | – | 3,494 | 4,801 |
| Other investments | | – | 927 | 5,585 | – | – | 6,512 | 5,622 |
| Deposits | | 1,224 | 92 | 10,320 | 160 | – | 11,796 | 11,236 |
| Assets held for sale* | | – | – | 10,578 | – | – | 10,578 | 38 |
| Cash and cash equivalents | | 2,189 | 3,005 | 4,749 | 2,182 | – | 12,125 | 10,690 |
| Total assets | | 94,199 | 204,918 | 209,201 | 6,802 | (6,475) | 508,645 | 493,941 |
| Total equity | | 6,428 | 5,624 | 8,700 | (3,485) | – | 17,267 | 16,094 |
| Liabilities | | | | | | | | |
| Insurance contract liabilities | C4.1 | 72,349 | 182,432 | 68,957 | 37 | (1,109) | 322,666 | 328,172 |
| Investment contract liabilities with discretionary participation features | C4.1 | 375 | – | 67,038 | – | – | 67,413 | 62,677 |
| Investment contract liabilities without discretionary participation features | C4.1 | 492 | 3,168 | 15,560 | 2 | – | 19,222 | 20,394 |
| Unallocated surplus of with-profits funds | C4.1 | 2,511 | – | 13,334 | – | – | 15,845 | 16,951 |
| Core structural borrowings of shareholder-financed businesses | C6.1 | – | 196 | – | 7,468 | – | 7,664 | 6,280 |
| Operational borrowings attributable to shareholder-financed businesses | C6.2 | 61 | 328 | 106 | 503 | – | 998 | 1,791 |
| Borrowings attributable to with-profits | C6.2 | 19 | – | 3,921 | – | – | 3,940 | 3,716 |

| | | | | | | | | |
|--|----|--------|---------|---------|--------|---------|---------|---------|
| businesses | | | | | | | | |
| Obligations under funding, securities lending and sale and repurchase agreements | | – | 5,765 | 1,224 | – | – | 6,989 | 5,662 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | | 2,617 | – | 9,013 | 21 | – | 11,651 | 8,889 |
| Deferred tax liabilities | C8 | 1,257 | 1,688 | 1,061 | 16 | – | 4,022 | 4,715 |
| Current tax liabilities | | 133 | 115 | 326 | 75 | (81) | 568 | 537 |
| Accruals, deferred income and other liabilities | | 7,641 | 5,324 | 6,442 | 1,126 | (5,285) | 15,248 | 14,185 |
| Provisions | | 251 | 23 | 743 | 61 | – | 1,078 | 1,123 |
| Derivative liabilities | | 65 | 255 | 2,208 | 978 | – | 3,506 | 2,755 |
| Liabilities held for sale* | | – | – | 10,568 | – | – | 10,568 | – |
| Total liabilities | | 87,771 | 199,294 | 200,501 | 10,287 | (6,475) | 491,378 | 477,847 |
| Total equity and liabilities | | 94,199 | 204,918 | 209,201 | 6,802 | (6,475) | 508,645 | 493,941 |

*

Assets held for sale of £10,578 million includes £10,568 million in respect of the reinsured UK annuity business. The corresponding policyholder and other liabilities of £10,568 million is reflected in liabilities held for sale (see note D1.1).

Note

Unallocated to a segment includes central operations, Prudential Capital and Africa operations as per note B1.3.

C2

Analysis of segment statement of financial position by business type

C2.1

Asia

| | | 31 Dec 2018 £m | | | | | 31 Dec 2017 £m | | |
|---|------|--|--|-------------------|-------|---------------------|----------------|-------|-------|
| | Note | Insurance With-profits business* | Unit-linked assets and liabilities | Other business | Total | Asset management | Eliminations | Total | Total |
| Assets | | | | | | | | | |
| Goodwill | | – | – | 251 | 251 | 247 | – | 498 | 305 |
| Deferred acquisition costs and other intangible | | 56 | – | 2,870 | 2,926 | 11 | – | 2,937 | 2,540 |

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| | | | | | | | | | |
|---|---------|--------|--------|--------|--------|-----|------|--------|--------|
| assets | | | | | | | | | |
| Property, plant and equipment | | 90 | – | 34 | 124 | 5 | – | 129 | 125 |
| Reinsurers' share of insurance contract liabilities | | 63 | – | 2,714 | 2,777 | – | – | 2,777 | 1,960 |
| Deferred tax assets | | – | 1 | 108 | 109 | 10 | – | 119 | 112 |
| Current tax recoverable | | – | 2 | 23 | 25 | 1 | – | 26 | 58 |
| Accrued investment income | | 254 | 51 | 327 | 632 | 32 | – | 664 | 595 |
| Other debtors | | 1,676 | 730 | 535 | 2,941 | 77 | (40) | 2,978 | 2,675 |
| Investment properties | | – | – | 5 | 5 | – | – | 5 | 5 |
| Investment in joint ventures and associates accounted for using the equity method | | – | – | 827 | 827 | 164 | – | 991 | 912 |
| Loans | C3.3 | 792 | – | 585 | 1,377 | – | – | 1,377 | 1,317 |
| Equity securities and portfolio holdings in unit trusts | | 17,165 | 12,804 | 2,146 | 32,115 | 35 | – | 32,150 | 29,976 |
| Debt securities | C3.2 | 27,204 | 3,981 | 14,583 | 45,768 | 71 | – | 45,839 | 40,982 |
| Derivative assets | | 201 | 4 | 91 | 296 | – | – | 296 | 113 |
| Deposits | | 250 | 455 | 458 | 1,163 | 61 | – | 1,224 | 1,291 |
| Cash and cash equivalents | | 870 | 326 | 874 | 2,070 | 119 | – | 2,189 | 1,934 |
| Total assets | | 48,621 | 18,354 | 26,431 | 93,406 | 833 | (40) | 94,199 | 84,900 |
| Total equity | | – | – | 5,868 | 5,868 | 560 | – | 6,428 | 5,926 |
| Liabilities | | | | | | | | | |
| Insurance contract liabilities | | 40,389 | 15,876 | 16,084 | 72,349 | – | – | 72,349 | 63,468 |
| Investment contract liabilities with discretionary participation features | C4.1(b) | 375 | – | – | 375 | – | – | 375 | 337 |
| Investment contract liabilities | C4.1(b) | – | 492 | – | 492 | – | – | 492 | 328 |

| | | | | | | | | |
|--|--------|--------|--------|--------|-----|------|--------|--------|
| without discretionary participation features | | | | | | | | |
| Unallocated surplus of with-profits funds | 2,511 | – | – | 2,511 | – | – | 2,511 | 3,474 |
| Operational borrowings attributable to shareholder-financed businesses | – | 50 | 11 | 61 | – | – | 61 | 50 |
| Borrowings attributable to with-profits businesses | 19 | – | – | 19 | – | – | 19 | 10 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | 1,242 | 1,024 | 351 | 2,617 | – | – | 2,617 | 3,631 |
| Deferred tax liabilities | 812 | 21 | 422 | 1,255 | 2 | – | 1,257 | 1,152 |
| Current tax liabilities | 27 | – | 93 | 120 | 13 | – | 133 | 122 |
| Accruals, deferred income and other liabilities | 3,138 | 889 | 3,475 | 7,502 | 179 | (40) | 7,641 | 6,069 |
| Provisions | 57 | – | 115 | 172 | 79 | – | 251 | 254 |
| Derivative liabilities | 51 | 2 | 12 | 65 | – | – | 65 | 79 |
| Total liabilities | 48,621 | 18,354 | 20,563 | 87,538 | 273 | (40) | 87,771 | 78,974 |
| Total equity and liabilities | 48,621 | 18,354 | 26,431 | 93,406 | 833 | (40) | 94,199 | 84,900 |

*

The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore operations. Assets and liabilities of other participating business are included in the column for 'Other business'.

C2.2 US

| | 31 Dec 2018 £m | | | | 31 Dec 2017 £m | | |
|------|--|-------------------------------------|-------|------------------|----------------|-------|-------|
| | Insurance | | | | | | |
| Note | Variable annuity separate account assets and | Fixed annuity, Total GICs and other | Total | Asset management | Eliminations | Total | Total |

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| | liabilities | business | | | | | |
|---|-------------|----------|---------|-----|------|---------|---------|
| Assets | | | | | | | |
| Goodwill | – | – | – | – | – | – | – |
| Deferred acquisition costs and other intangible assets | – | 8,747 | 8,747 | – | – | 8,747 | 8,219 |
| Property, plant and equipment | – | 243 | 243 | 3 | – | 246 | 214 |
| Reinsurers' share of insurance contract liabilities | – | 6,662 | 6,662 | – | – | 6,662 | 6,424 |
| Deferred tax assets | – | 2,271 | 2,271 | 24 | – | 2,295 | 2,300 |
| Current tax recoverable | – | 309 | 309 | 2 | – | 311 | 298 |
| Accrued investment income | – | 493 | 493 | 5 | – | 498 | 492 |
| Other debtors | – | 230 | 230 | 76 | (68) | 238 | 248 |
| Investment properties | – | 6 | 6 | – | – | 6 | 5 |
| Loans | C3.3 – | 11,066 | 11,066 | – | – | 11,066 | 9,630 |
| Equity securities and portfolio holdings in unit trusts | 128,220 | 433 | 128,653 | 4 | – | 128,657 | 130,630 |
| Debt securities | C3.2 – | 41,594 | 41,594 | – | – | 41,594 | 35,378 |
| Derivative assets | – | 574 | 574 | – | – | 574 | 1,611 |
| Other investments | – | 926 | 926 | 1 | – | 927 | 848 |
| Deposits | – | – | – | 92 | – | 92 | 43 |
| Cash and cash equivalents | – | 2,976 | 2,976 | 29 | – | 3,005 | 1,658 |
| Total assets | 128,220 | 76,530 | 204,750 | 236 | (68) | 204,918 | 197,998 |
| Total equity | – | 5,584 | 5,584 | 40 | – | 5,624 | 5,248 |
| Liabilities | | | | | | | |
| Insurance contract liabilities | 128,220 | 54,212 | 182,432 | – | – | 182,432 | 177,728 |
| Investment contract liabilities without discretionary participation | C4.1(c) – | 3,168 | 3,168 | – | – | 3,168 | 2,996 |

| | | | | | | | |
|--|---------|--------|---------|-----|------|---------|---------|
| features | | | | | | | |
| Core structural borrowings of shareholder-financed businesses | – | 196 | 196 | – | – | 196 | 184 |
| Operational borrowings attributable to shareholder-financed businesses | – | 328 | 328 | – | – | 328 | 508 |
| Obligations under funding, securities lending and sale and repurchase agreements | – | 5,765 | 5,765 | – | – | 5,765 | 4,304 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | – | – | – | – | – | – | – |
| Deferred tax liabilities | – | 1,688 | 1,688 | – | – | 1,688 | 1,845 |
| Current tax liabilities | – | 114 | 114 | 1 | – | 115 | 47 |
| Accruals, deferred income and other liabilities | – | 5,197 | 5,197 | 195 | (68) | 5,324 | 5,109 |
| Provisions | – | 23 | 23 | – | – | 23 | 24 |
| Derivative liabilities | – | 255 | 255 | – | – | 255 | 5 |
| Total liabilities | 128,220 | 70,946 | 199,166 | 196 | (68) | 199,294 | 192,750 |
| Total equity and liabilities | 128,220 | 76,530 | 204,750 | 236 | (68) | 204,918 | 197,998 |

C2.3
UK and Europe

| | 31 Dec 2018 £m | | | | | | 31 Dec 2017 £m | |
|------|------------------------|------------------------------------|--------------------------------------|-------|------------------|--------------|----------------|-------|
| | Insurance | | Other funds and subsidiaries | | | | | |
| Note | With-profits business* | Unit-linked assets and liabilities | Annuity and other long-term business | Total | Asset management | Eliminations | Total | Total |

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| | | | | | | | | | |
|---|-------------|--------|--------|--------|-------|-------|--------|--------|--|
| Assets | | | | | | | | | |
| Goodwill | 206 | – | – | 206 | 1,153 | – | 1,359 | 1,177 | |
| Deferred acquisition costs and other intangible assets | 83 | – | 94 | 177 | 18 | – | 195 | 210 | |
| Property, plant and equipment | 895 | – | 39 | 934 | 97 | – | 1,031 | 447 | |
| Reinsurers' share of insurance contract liabilities | 1,131 | 115 | 1,566 | 2,812 | – | – | 2,812 | 2,521 | |
| Deferred tax assets | 61 | – | 45 | 106 | 20 | – | 126 | 157 | |
| Current tax recoverable | 58 | 6 | 174 | 238 | 6 | – | 244 | 244 | |
| Accrued investment income | 1,010 | 116 | 378 | 1,504 | 7 | – | 1,511 | 1,558 | |
| Other debtors | 2,102 | 575 | 641 | 3,318 | 1,011 | (140) | 4,189 | 3,118 | |
| Investment properties | 15,635 | 618 | 1,661 | 17,914 | – | – | 17,914 | 16,487 | |
| Investment in joint ventures and associates accounted for using the equity method | 705 | – | – | 705 | 37 | – | 742 | 504 | |
| Loans | C3.3 3,853 | – | 1,714 | 5,567 | – | – | 5,567 | 5,986 | |
| Equity securities and portfolio holdings in unit trusts | 41,090 | 12,477 | 20 | 53,587 | 223 | – | 53,810 | 62,670 | |
| Debt securities | C3.2 53,798 | 10,512 | 21,646 | 85,956 | – | – | 85,956 | 92,707 | |
| Derivative assets | 1,957 | 1 | 555 | 2,513 | – | – | 2,513 | 2,954 | |
| Other investments | 5,573 | 10 | 1 | 5,584 | 1 | – | 5,585 | 4,774 | |

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| | | | | | | | | |
|--|----------------|--------|--------|---------|-------|-------|---------|---------|
| Deposits | 8,530 | 1,101 | 689 | 10,320 | – | – | 10,320 | 9,540 |
| Assets held for sale | 10 | – | 10,568 | 10,578 | – | – | 10,578 | 38 |
| Cash and cash equivalents | 3,520 | 190 | 688 | 4,398 | 351 | – | 4,749 | 5,808 |
| Total assets | 140,217 | 25,721 | 40,479 | 206,417 | 2,924 | (140) | 209,201 | 210,900 |
| Total equity | – | – | 6,540 | 6,540 | 2,160 | – | 8,700 | 8,245 |
| Liabilities | | | | | | | | |
| Insurance contract liabilities | C4.1(d) 43,775 | 5,219 | 19,963 | 68,957 | – | – | 68,957 | 88,180 |
| Investment contract liabilities with discretionary participation features | C4.1(d) 67,018 | – | 20 | 67,038 | – | – | 67,038 | 62,340 |
| Investment contract liabilities without discretionary participation features | C4.1(d) 2 | 15,498 | 60 | 15,560 | – | – | 15,560 | 17,069 |
| Unallocated surplus of with-profits funds | 13,334 | – | – | 13,334 | – | – | 13,334 | 13,477 |
| Operational borrowings attributable to shareholder-financed businesses | – | 4 | 102 | 106 | – | – | 106 | 148 |
| Borrowings attributable to with-profits businesses | 3,921 | – | – | 3,921 | – | – | 3,921 | 3,706 |
| Obligations under funding, securities lending and sale and | 999 | – | 225 | 1,224 | – | – | 1,224 | 1,358 |

| | | | | | | | | |
|--|---------|--------|--------|---------|-------|-------|---------|---------|
| repurchase agreements | | | | | | | | |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | 4,349 | 4,643 | 21 | 9,013 | – | – | 9,013 | 5,243 |
| Deferred tax liabilities | 892 | – | 147 | 1,039 | 22 | – | 1,061 | 1,703 |
| Current tax liabilities | 29 | – | 269 | 298 | 28 | – | 326 | 377 |
| Accruals deferred income and other liabilities | 4,601 | 354 | 1,141 | 6,096 | 486 | (140) | 6,442 | 6,609 |
| Provisions | 32 | – | 484 | 516 | 227 | – | 743 | 784 |
| Derivative liabilities | 1,265 | 3 | 939 | 2,207 | 1 | – | 2,208 | 1,661 |
| Liabilities held for sale | – | – | 10,568 | 10,568 | – | – | 10,568 | – |
| Total liabilities | 140,217 | 25,721 | 33,939 | 199,877 | 764 | (140) | 200,501 | 202,655 |
| Total equity and liabilities | 140,217 | 25,721 | 40,479 | 206,417 | 2,924 | (140) | 209,201 | 210,900 |

*

Includes the Scottish Amicable Insurance Fund which, at 31 December 2018, had total assets and liabilities of £4,844 million (2017: £5,768 million). The PAC with-profits sub-fund (WPSF) mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The UK with-profits fund includes £9.5 billion (2017: £10.6 billion) of non-profits annuities liabilities.

C3

Assets and liabilities

C3.1

Group assets and liabilities – measurement

(a)

Determination of fair value

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments or by using quotations from independent third parties

such as brokers and pricing services or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm's-length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third parties or valued internally using standard market practices.

Other than the loans which have been designated at fair value through profit or loss, the loans and receivables have been shown net of provisions for impairment. The fair value of loans have been estimated from discounted cash flows expected to be received. The discount rate is updated for the market rate of interest where applicable.

The fair value of investment properties is based on market values as assessed by professionally qualified external valuers or by the Group's qualified surveyors.

The fair value of the subordinated and senior debt issued by the parent company is determined using quoted prices from independent third parties.

The fair value of financial liabilities (other than derivative financial instruments) is determined using discounted cash flows of the amounts expected to be paid.

(b)

Fair value measurement hierarchy of Group assets and liabilities

Assets and liabilities carried at fair value on the statement of financial position

The table below shows the assets and liabilities carried at fair value analysed by level of the IFRS 13, 'Fair Value Measurement' defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

Financial instruments at fair value

| | 31 Dec 2018 £m | | | Total |
|---|---|---|---|---------|
| | Level 1 Quoted prices (unadjusted) in active markets | Level 2 Valuation based on significant observable market inputs | Level 3 Valuation based on significant unobservable market inputs | |
| Analysis of financial investments, net of derivative liabilities by business type | | | | |
| With-profits | | | | |
| Loans | – | – | 1,703 | 1,703 |
| Equity securities and portfolio holdings in unit trusts | 52,320 | 5,447 | 488 | 58,255 |
| Debt securities | 31,210 | 48,981 | 811 | 81,002 |
| Other investments (including derivative assets) | 143 | 3,263 | 4,325 | 7,731 |
| Derivative liabilities | (85) | (1,231) | – | (1,316) |

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| | | | | |
|--|---------|---------|-------|---------|
| Total financial investments, net of derivative liabilities | 83,588 | 56,460 | 7,327 | 147,375 |
| Percentage of total | 57% | 38% | 5% | 100% |
| Unit-linked and variable annuity separate account | | | | |
| Equity securities and portfolio holdings in unit trusts | 152,987 | 505 | 9 | 153,501 |
| Debt securities | 4,766 | 9,727 | – | 14,493 |
| Other investments (including derivative assets) | 6 | 3 | 6 | 15 |
| Derivative liabilities | (2) | (3) | – | (5) |
| Total financial investments, net of derivative liabilities | 157,757 | 10,232 | 15 | 168,004 |
| Percentage of total | 94% | 6% | 0% | 100% |
| Non-linked shareholder-backed | | | | |
| Loans | – | – | 3,050 | 3,050 |
| Equity securities and portfolio holdings in unit trusts | 2,957 | 2 | 18 | 2,977 |
| Debt securities | 17,687 | 61,803 | 371 | 79,861 |
| Other investments (including derivative assets) | 61 | 1,258 | 941 | 2,260 |
| Derivative liabilities | (2) | (1,760) | (423) | (2,185) |
| Total financial investments, net of derivative liabilities | 20,703 | 61,303 | 3,957 | 85,963 |
| Percentage of total | 24% | 71% | 5% | 100% |
| Group total analysis, including other financial liabilities held at fair value | | | | |
| Loans | – | – | 4,753 | 4,753 |
| Equity securities and portfolio holdings in unit trusts | 208,264 | 5,954 | 515 | 214,733 |
| Debt securities | 53,663 | 120,511 | 1,182 | 175,356 |
| | 210 | 4,524 | 5,272 | 10,006 |

| | | | | |
|--|---------|----------|---------|----------|
| Other investments (including derivative assets) | | | | |
| Derivative liabilities | (89) | (2,994) | (423) | (3,506) |
| Total financial investments, net of derivative liabilities | 262,048 | 127,995 | 11,299 | 401,342 |
| Investment contract liabilities without discretionary participation features held at fair value | – | (16,054) | – | (16,054) |
| Borrowings attributable to with-profits businesses | – | – | (1,606) | (1,606) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (6,852) | (3,811) | (988) | (11,651) |
| Other financial liabilities held at fair value | – | (2) | (3,404) | (3,406) |
| Total financial instruments at fair value | 255,196 | 108,128 | 5,301 | 368,625 |
| Percentage of total | 70% | 29% | 1% | 100% |

31 Dec 2017 £m

| | Level 1 Quoted prices (unadjusted) in active markets | Level 2 Valuation based on significant observable market inputs | Level 3 Valuation based on significant unobservable market inputs | Total |
|---|---|---|---|--------|
| Analysis of financial investments, net of derivative liabilities by business type | | | | |
| With-profits | | | | |
| Loans | – | – | 2,023 | 2,023 |
| Equity securities and portfolio holdings in unit trusts | 57,347 | 4,470 | 351 | 62,168 |
| Debt securities | 29,143 | 45,602 | 348 | 75,093 |
| | 68 | 3,638 | 3,540 | 7,246 |

| | | | | |
|--|---------|---------|-------|---------|
| Other investments (including derivative assets) | | | | |
| Derivative liabilities | (68) | (615) | – | (683) |
| Total financial investments, net of derivative liabilities | 86,490 | 53,095 | 6,262 | 145,847 |
| Percentage of total | 60% | 36% | 4% | 100% |
| Unit-linked and variable annuity separate account | | | | |
| Equity securities and portfolio holdings in unit trusts | 158,631 | 457 | 10 | 159,098 |
| Debt securities | 4,993 | 5,226 | – | 10,219 |
| Other investments (including derivative assets) | 12 | 4 | 8 | 24 |
| Derivative liabilities | – | (1) | – | (1) |
| Total financial investments, net of derivative liabilities | 163,636 | 5,686 | 18 | 169,340 |
| Percentage of total | 97% | 3% | 0% | 100% |
| Non-linked shareholder-backed | | | | |
| Loans | – | – | 2,814 | 2,814 |
| Equity securities and portfolio holdings in unit trusts | 2,105 | 10 | 10 | 2,125 |
| Debt securities | 21,443 | 64,313 | 306 | 86,062 |
| Other investments (including derivative assets) | 7 | 2,270 | 876 | 3,153 |
| Derivative liabilities | – | (1,559) | (512) | (2,071) |
| Total financial investments, net of derivative liabilities | 23,555 | 65,034 | 3,494 | 92,083 |
| Percentage of total | 25% | 71% | 4% | 100% |
| Group total analysis, including other financial liabilities held at fair value | | | | |
| Loans | – | – | 4,837 | 4,837 |
| | 218,083 | 4,937 | 371 | 223,391 |

| | | | | |
|---|---------|----------|---------|----------|
| Equity securities and portfolio holdings in unit trusts | | | | |
| Debt securities | 55,579 | 115,141 | 654 | 171,374 |
| Other investments (including derivative assets) | 87 | 5,912 | 4,424 | 10,423 |
| Derivative liabilities | (68) | (2,175) | (512) | (2,755) |
| Total financial investments, net of derivative liabilities | 273,681 | 123,815 | 9,774 | 407,270 |
| Investment contract liabilities without discretionary participation features held at fair value | | | | |
| Borrowings attributable to with-profits businesses | – | (17,397) | – | (17,397) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (4,836) | (3,640) | (413) | (8,889) |
| Other financial liabilities held at fair value | – | – | (3,031) | (3,031) |
| Total financial instruments at fair value | 268,845 | 102,778 | 4,443 | 376,066 |
| Percentage of total | 72% | 27% | 1% | 100% |

All assets and liabilities held at fair value are classified as fair value through profit or loss, except for £40,849 million (31 December 2017: £35,293 million) of debt securities classified as available-for-sale.

Investment properties at fair value

| | 31 Dec £m | | | |
|------|---|--|---|--------|
| | Level 1 Quoted prices (unadjusted) in active markets | Level 2 Valuation based on significant observable market inputs | Level 3 Valuation based on significant unobservable market inputs | Total |
| 2018 | – | – | 17,925 | 17,925 |
| 2017 | – | – | 16,497 | 16,497 |

(c)

Valuation approach for level 2 fair valued assets and liabilities

A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using a designated independent pricing service or quote from third-party brokers. These valuations are subject to a number of monitoring controls, such as comparison to multiple pricing sources where available, monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

When prices are not available from pricing services, quotes are sourced directly from brokers. Prudential seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness and regularity of the quotes and the accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third-party valuations obtained do not reflect fair value (eg either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation. In these instances, prices are derived using internal valuation techniques including those as described below in this note with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date. The techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. Prudential determines the input assumptions based on the best available information at the measurement dates. Securities valued in such manner are classified as level 3 where these significant inputs are not based on observable market data.

Of the total level 2 debt securities of £120,511 million at 31 December 2018 (31 December 2017: £115,141 million), £15,425 million are valued internally (31 December 2017: £13,910 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

(d)

Fair value measurements for level 3 fair valued assets and liabilities

Valuation approach for level 3 fair valued assets and liabilities

Financial instruments at fair value

Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions, eg market illiquidity. The valuation techniques used include comparison to recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources when available, but overall the source of pricing is chosen with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement

date.

The fair value estimates are made at a specific point in time, based upon available market information and judgements about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time a significant volume of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued.

In accordance with the Group's risk management framework, the estimated fair value of derivative financial instruments valued internally using standard market practices are subject to assessment against external counterparties' valuations.

At 31 December 2018, the Group held £5,301 million (31 December 2017: £4,443 million) of net financial instruments at fair value within level 3. This represents 1 per cent (31 December 2017: 1 per cent) of the total fair valued financial assets net of fair valued financial liabilities. The principal financial assets, net of corresponding liabilities, classified as fair value within level 3 as of 31 December 2018 are described below:

(i)
£1,702 million of loans (31 December 2017: £1,983 million) and a corresponding £1,606 million (31 December 2017: £1,887 million) of borrowings are held by a subsidiary of the Group's UK with-profits fund, attaching to a portfolio of buy-to-let mortgages and other loans financed largely by external third-party (non-recourse) borrowings. See note C3.3(c) for further details. The Group's exposure is limited to the investment held by the UK with-profits fund, rather than to the individual loans and borrowings themselves. The fair value movements of these loans and borrowings have no effect on shareholders' profit and equity. The most significant non observable inputs to the mortgage fair value are the level of future defaults and prepayments by the mortgage holders.

(ii)
Loans of £2,783 million at 31 December 2018 (31 December 2017: £2,512 million), measured as the loan outstanding balance, plus accrued investment income, attached to acquired REALIC business and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,941 million at 31 December 2018 (31 December 2017: £2,664 million) is also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

(iii)
Excluding the above, the level 3 fair valued financial assets net of financial liabilities are £5,363 million (31 December 2017: £4,499 million). Of this amount, a net liability of £(298) million (31 December 2017: net liability of £(117) million) is internally valued, representing less than 0.1 per cent of the total fair valued financial assets net of financial liabilities (31 December 2017: less than 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net asset/liability are:

a)
Debt securities of £582 million (31 December 2017: £500 million), which are either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured).

b)
Private equity and venture investments in both debt and equity securities of £512 million (31 December 2017: £217 million) which are valued internally using discounted cash flows based on management information available for these investments. The significant unobservable inputs include the determination of expected future cash flows on the investments being valued, determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The valuation is performed in accordance with International Private Equity and Venture Capital Association Valuation guidelines. These investments are principally held by consolidated investment funds

that are managed on behalf of third parties.

c)

Equity release mortgage loan investments of £268 million and a corresponding loan liability backed by these investments of £(354) million (31 December 2017: £302 million loan investments and a corresponding liability of £(385) million) which are valued internally using the discounted cash flow models. The inputs that are significant to the valuation of these investments are primarily the economic assumptions, being the discount rate (risk-free rate plus a liquidity premium) and property values.

d)

Liabilities of £(898) million (31 December 2017: £(403) million) for the net asset value attributable to external unit holders in respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets.

e)

Derivative liabilities of £(423) million (31 December 2017: £(512) million) which are valued internally using the discounted cash flow method in line with standard market practices but are subject to independent assessment against external counterparties' valuations.

f)

Other sundry individual financial investments of £15 million (31 December 2017: £164 million).

Of the internally valued net liability referred to above of £(298) million (31 December 2017: net liability of £(117) million):

–

A net liability of £(53) million (31 December 2017: net asset £67 million) is held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments; and

A net liability of £(245) million (31 December 2017: £(184) million) is held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally decreased by 10 per cent, the change in valuation would be £24 million (31 December 2017: £18 million), which would reduce shareholders' equity by this amount before tax. All this amount passes through the income statement substantially as part of short-term fluctuations in investment returns outside of adjusted IFRS operating profit based on longer-term investment returns.

Other assets at fair value – investment properties

The investment properties of the Group are principally held by the UK and Europe insurance operations that are externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors (RICS) valuation standards. An 'income capitalisation' technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the Group's investment properties. As the comparisons are not with properties that are virtually identical to the Group's investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.

(e)

Transfers into and transfers out of levels

The Group's policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer. Transfers are deemed to have occurred when there is a material change in the observed valuation inputs or a change in the level of trading activities of the securities.

During the year, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to level 2 of £908 million and transfers from level 2 to level 1 of £976 million. These transfers which relate to equity securities

and debt securities arose to reflect the change in the observed valuation inputs and in certain cases, the change in the level of trading activities of the securities.

In addition, the transfers into level 3 during the year were £8 million and the transfers out of level 3 were £30 million. These transfers were primarily between levels 3 and 2 for derivative liabilities.

(f)

Valuation processes applied by the Group

The Group's valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by business unit committees as part of the Group's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions. In addition, the Group has minimum standards for independent price verification to ensure valuation accuracy is regularly independently verified. Adherence to this policy is monitored across the business units.

C3.2

Debt securities

This note provides analysis of the Group's debt securities, including asset-backed securities and sovereign debt securities.

With the exception of certain debt securities for US insurance operations classified as 'available-for-sale' under IAS 39 as disclosed in notes C3.2(b) to (d) below, the Group's debt securities are carried at fair value through profit or loss.

(a)

Credit rating

Debt securities are analysed below according to external credit ratings issued, with equivalent ratings issued by different ratings agencies grouped together. Standard & Poor's ratings have been used where available, if this isn't the case Moody's and then Fitch have been used as alternatives. For the US, NAIC ratings have also been used where relevant. In the table below, AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB- ratings. Financial assets which fall outside this range are classified as below BBB-. Debt securities with no external credit rating are classified as 'Other'.

| | 31 Dec 2018 £m | | | | | | Total |
|-------------------------------|----------------|------------|----------|--------------|------------|--------|---------|
| | AAA | AA+ to AA- | A+ to A- | BBB+ to BBB- | Below BBB- | Other | |
| Asia | | | | | | | |
| With-profits | 2,873 | 12,379 | 4,142 | 3,760 | 1,747 | 2,303 | 27,204 |
| Unit-linked | 817 | 100 | 492 | 1,431 | 426 | 715 | 3,981 |
| Non-linked shareholder-backed | 1,034 | 3,552 | 3,717 | 2,934 | 2,202 | 1,144 | 14,583 |
| Asset management | 11 | - | 60 | - | - | - | 71 |
| US | | | | | | | |
| Non-linked shareholder-backed | 678 | 7,383 | 10,286 | 14,657 | 1,429 | 7,161 | 41,594 |
| UK and Europe | | | | | | | |
| With-profits | 6,890 | 9,332 | 11,779 | 14,712 | 2,891 | 8,194 | 53,798 |
| Unit-linked | 1,041 | 2,459 | 2,215 | 3,501 | 395 | 901 | 10,512 |
| Non-linked shareholder-backed | 3,007 | 6,413 | 4,651 | 1,515 | 158 | 5,902 | 21,646 |
| Other operations | 619 | 1,089 | 151 | 41 | 49 | 18 | 1,967 |
| Total debt securities | 16,970 | 42,707 | 37,493 | 42,551 | 9,297 | 26,338 | 175,356 |

31 Dec 2017 £m

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| | AAA | AA+ to AA- | A+ to A- | BBB+ to BBB- | Below BBB- | Other | Total |
|-------------------------------|--------|------------|----------|-----------------|------------|--------|---------|
| Asia: | | | | | | | |
| With-profits | 2,504 | 10,641 | 3,846 | 3,234 | 1,810 | 2,397 | 24,432 |
| Unit-linked | 528 | 103 | 510 | 1,429 | 372 | 565 | 3,507 |
| Non-linked shareholder-backed | 990 | 2,925 | 3,226 | 2,970 | 1,879 | 1,053 | 13,043 |
| US: | | | | | | | |
| Non-linked shareholder-backed | 368 | 6,352 | 9,578 | 12,311 | 1,000 | 5,769 | 35,378 |
| UK and Europe: | | | | | | | |
| With-profits | 6,492 | 9,378 | 11,666 | 12,856 | 2,877 | 7,392 | 50,661 |
| Unit-linked | 670 | 2,732 | 1,308 | 1,793 | 91 | 117 | 6,711 |
| Non-linked shareholder-backed | 5,118 | 11,005 | 9,625 | 3,267 | 258 | 6,062 | 35,335 |
| Other operations | 742 | 1,264 | 182 | 67 | 36 | 16 | 2,307 |
| Total debt securities | 17,412 | 44,400 | 39,941 | 37,927 | 8,323 | 23,371 | 171,374 |

The credit ratings, information or data contained in this report which are attributed and specifically provided by Standard & Poor's, Moody's and Fitch Solutions and their respective affiliates and suppliers ('Content Providers') is referred to here as the 'Content'. Reproduction of any Content in any form is prohibited except with the prior written permission of the relevant party. The Content Providers do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. The Content Providers expressly disclaim liability for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold any such investment or security, nor does it address the suitability of an investment or security and should not be relied on as investment advice.

Securities with credit ratings classified as 'Other' can be further analysed as follows:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Asia – non-linked shareholder-backed | | |
| Internally rated: | | |
| Government bonds | 36 | 25 |
| Corporate bonds – rated as investment grade by local external ratings agencies | 978 | 959 |
| Other | 130 | 69 |
| Total Asia non-linked shareholder-backed | 1,144 | 1,053 |

| | 31 Dec 2018 £m | | | 31 Dec 2017 £m |
|--|----------------------------|------------------|-------|----------------|
| | Mortgage-backed securities | Other securities | Total | Total |
| US | | | | |
| Implicit ratings of other US debt securities based on NAIC* valuations (see below) | | | | |
| NAIC 1 | 2,148 | 2,858 | 5,006 | 3,918 |

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| | | | | |
|-----------|-------|-------|-------|-------|
| NAIC 2 | 2 | 2,116 | 2,118 | 1,794 |
| NAIC 3-6 | 2 | 35 | 37 | 57 |
| Total US† | 2,152 | 5,009 | 7,161 | 5,769 |

*

The Securities Valuation Office of the NAIC classifies debt securities into six quality categories ranging from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5 and securities in or near default are designated Class 6.

†

Mortgage-backed securities totalling £1,947 million at 31 December 2018 have credit ratings issued by Standard & Poor's of BBB- or above and hence are designated as investment grade. Other securities totalling £4,974 million at 31 December 2018 with NAIC ratings 1 or 2 are also designated as investment grade.

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|-----------------------------|----------------|----------------|
| UK and Europe | | |
| Internal ratings or unrated | | |
| AAA to A- | 8,150 | 7,994 |
| BBB to B- | 3,034 | 3,141 |
| Below B- or unrated | 3,813 | 2,436 |
| Total UK and Europe | 14,997 | 13,571 |

(b)

Additional analysis of US insurance operations debt securities

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|---|----------------|----------------|
| Corporate and government security and commercial loans: | | |
| Government | 5,465 | 4,835 |
| Publicly traded and SEC Rule 144A securities* | 26,196 | 22,849 |
| Non-SEC Rule 144A securities | 6,329 | 4,468 |
| Asset-backed securities (see note (e)) | 3,604 | 3,226 |
| Total US debt securities† | 41,594 | 35,378 |

*

A 1990 SEC rule that facilitates the resale of privately placed securities under Rule 144A that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

†

Debt securities for US operations included in the statement of financial position comprise:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|-----------------------------------|----------------|----------------|
| Available-for-sale | 40,849 | 35,293 |
| Fair value through profit or loss | 745 | 85 |
| Total US debt securities | 41,594 | 35,378 |

Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

(c)

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Movements in unrealised gains and losses on Jackson available-for-sale securities

The movement in the statement of financial position value for debt securities classified as available-for-sale was from a net unrealised gain of £1,205 million to a net unrealised loss of £414 million as analysed in the table below.

| | 2018 £m | Reflected as part of movement in other comprehensive income | | 2017 £m |
|--|------------|---|---|------------|
| | | Foreign exchange translation £m | Changes in unrealised appreciation† £m | |
| Assets fair valued at below book value | | | | |
| Book value* | 25,330 | | | 6,325 |
| Unrealised gain (loss) | (925) | (43) | (776) | (106) |
| Fair value (as included in statement of financial position) | 24,405 | | | 6,219 |
| Assets fair valued at or above book value | | | | |
| Book value* | 15,933 | | | 27,763 |
| Unrealised gain (loss) | 511 | 41 | (841) | 1,311 |
| Fair value (as included in statement of financial position) | 16,444 | | | 29,074 |
| Total | | | | |
| Book value* | 41,263 | | | 34,088 |
| Net unrealised gain (loss) | (414) | (2) | (1,617) | 1,205 |
| Fair value (as included in the footnote above in the overview table and the statement of financial position) | 40,849 | | | 35,293 |

*

Book value represents cost/amortised cost of the debt securities.

†

Translated at the average rate of US\$1.3352:£1.00.

(d)

US debt securities classified as available-for-sale in an unrealised loss position

(i)

Fair value of securities as a percentage of book value

The fair value of the debt securities in a gross unrealised loss position for various percentages of book value:

| | 31 Dec 2018 £m | | 31 Dec 2017 £m | |
|-------------------------------|----------------|--------------------|----------------|--------------------|
| | Fair value | Unrealised loss | Fair value | Unrealised loss |
| Between 90% and 100% | 23,662 | (809) | 6,170 | (95) |
| Between 80% and 90% | 707 | (104) | 36 | (6) |
| Below 80%: | | | | |
| Other asset-backed securities | – | – | 10 | (4) |
| Corporate bonds | 36 | (12) | 3 | (1) |
| | 36 | (12) | 13 | (5) |
| Total | 24,405 | (925) | 6,219 | (106) |

(ii)

Unrealised losses by maturity of security

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|-------------------|----------------|----------------|
| 1 year to 5 years | (72) | (7) |

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| | | |
|---|-------|-------|
| 5 years to 10 years | (436) | (41) |
| More than 10 years | (372) | (39) |
| Mortgage-backed and other debt securities | (45) | (19) |
| Total | (925) | (106) |

(iii)
Age analysis of unrealised losses for the periods indicated
The age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

| | 31 Dec 2018 £m | | | 31 Dec 2017 £m | | |
|--------------------|----------------------|------------------|-------|----------------------|------------------|-------|
| | Non-investment grade | Investment grade | Total | Non-investment grade | Investment grade | Total |
| Less than 6 months | (20) | (141) | (161) | (4) | (31) | (35) |
| 6 months to 1 year | (22) | (440) | (462) | (1) | (4) | (5) |
| 1 year to 2 years | (10) | (142) | (152) | – | (49) | (49) |
| 2 years to 3 years | – | (123) | (123) | (1) | (6) | (7) |
| More than 3 years | (2) | (25) | (27) | – | (10) | (10) |
| Total | (54) | (871) | (925) | (6) | (100) | (106) |

The age analysis as at 31 December, of the securities whose fair values were below 80 per cent of the book value:

| Age analysis | 31 Dec 2018 £m | | 31 Dec 2017 £m | |
|----------------------|----------------|-----------------|----------------|-----------------|
| | Fair value | Unrealised loss | Fair value | Unrealised loss |
| Less than 3 months | 32 | (10) | 2 | – |
| 3 months to 6 months | 2 | (1) | 1 | (1) |
| More than 6 months | 2 | (1) | 10 | (4) |
| Total | 36 | (12) | 13 | (5) |

(e)
Asset-backed securities
The Group's holdings in Asset-Backed Securities (ABS), which comprise Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS), Collateralised Debt Obligations (CDO) funds and other asset-backed securities are as follows:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Shareholder-backed business | | |
| Asia operationsnote (i) | 121 | 118 |
| US operationsnote (ii) | 3,604 | 3,226 |
| UK and Europe operations (2018: 42% AAA, 13% AA)note (iii) | 1,406 | 1,070 |
| Other operationsnote (iv) | 445 | 589 |
| | 5,576 | 5,003 |
| With-profits business | | |
| Asia operationsnote (i) | 235 | 233 |
| UK and Europe operations (2018: 66% AAA, 12% AA)note (iii) | 5,270 | 5,658 |
| | 5,505 | 5,891 |
| Total | 11,081 | 10,894 |

Notes

(i)

Asia operations

The Asia operations' exposure to asset-backed securities is primarily held by the with-profits businesses. Of the £235 million (31 December 2017: £233 million), 99.8 per cent (2017: 98.2 per cent) are investment grade.

(ii)

US operations

US operations' exposure to asset-backed securities at 31 December comprises:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|---|----------------|----------------|
| RMBS | | |
| Sub-prime (2018: 1% AAA, 6% AA, 2% A) | 96 | 112 |
| Alt-A (2018: 3% AAA, 42% A) | 105 | 126 |
| Prime including agency (2018: 14% AAA, 62% AA, 10% A) | 441 | 440 |
| CMBS (2018: 80% AAA, 15% AA, 2% A) | 1,945 | 1,579 |
| CDO funds (2018: 13% AA, 24% A), including £nil exposure to sub-prime | 13 | 28 |
| Other ABS (2018: 20% AAA, 14% AA, 49% A), including £77 million exposure to sub-prime | 1,004 | 941 |
| Total | 3,604 | 3,226 |

(iii)

UK and Europe operations

The majority of holdings of the shareholder-backed business are UK securities and relate to PAC's annuity business. Of the holdings of the with-profits businesses, £1,823 million (31 December 2017: £1,913 million) relates to exposure to the US markets with the remaining exposure being primarily to the UK market.

(iv)

Other operations

Other operations' exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £445 million, 99 per cent (31 December 2017: 96 per cent) are graded AAA.

(f)

Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities are analysed as follows:

Exposure to sovereign debts

| | 31 Dec 2018 £m | | 31 Dec 2017 £m | |
|-----------------------|-----------------------------|--------------------|-----------------------------|--------------------|
| | Shareholder-backed business | With-profits funds | Shareholder-backed business | With-profits funds |
| Italy | – | 57 | 58 | 63 |
| Spain | 36 | 18 | 34 | 18 |
| France | – | 50 | 23 | 38 |
| Germany* | 239 | 281 | 693 | 301 |
| Other Eurozone | 103 | 34 | 82 | 31 |
| Total Eurozone | 378 | 440 | 890 | 451 |
| United Kingdom | 3,226 | 3,013 | 5,918 | 3,287 |
| United States† | 5,647 | 11,858 | 5,078 | 10,156 |

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| | | | | |
|-----------------------|--------|--------|--------|--------|
| Other, including Asia | 5,142 | 2,745 | 4,638 | 2,143 |
| Total | 14,393 | 18,056 | 16,524 | 16,037 |

*

Including bonds guaranteed by the federal government.

†

The exposure to the United States sovereign debt comprises holdings of the US, the UK and Europe and Asia insurance operations.

Exposure to bank debt securities

| | 31 Dec 2018 £m | | | 31 Dec 2017 £m | | | | |
|-----------------------------|----------------|--------|-------|-------------------|--------|-------|-------|-------|
| | Senior debt | | | Subordinated debt | | | Total | Total |
| Shareholder-backed business | Covered | Senior | Total | Tier 1 | Tier 2 | Total | Total | Total |
| Spain | 42 | 64 | 106 | – | – | – | 106 | 68 |
| France | 20 | 119 | 139 | 14 | 3 | 17 | 156 | 86 |
| Germany | 30 | – | 30 | 6 | 89 | 95 | 125 | 117 |
| Netherlands | – | 69 | 69 | 3 | 1 | 4 | 73 | 71 |
| Other Eurozone | 15 | 2 | 17 | – | – | – | 17 | 15 |
| Total Eurozone | 107 | 254 | 361 | 23 | 93 | 116 | 477 | 357 |
| United Kingdom | 550 | 623 | 1,173 | 9 | 164 | 173 | 1,346 | 1,382 |
| United States | – | 2,614 | 2,614 | 1 | 52 | 53 | 2,667 | 2,619 |
| Other, including Asia | – | 759 | 759 | 109 | 369 | 478 | 1,237 | 1,163 |
| Total | 657 | 4,250 | 4,907 | 142 | 678 | 820 | 5,727 | 5,521 |
| With-profits funds | | | | | | | | |
| Italy | – | 38 | 38 | – | – | – | 38 | 31 |
| Spain | – | 17 | 17 | – | – | – | 17 | 16 |
| France | 6 | 250 | 256 | 1 | 95 | 96 | 352 | 286 |
| Germany | 140 | 46 | 186 | 14 | 29 | 43 | 229 | 180 |
| Netherlands | – | 253 | 253 | 12 | 1 | 13 | 266 | 199 |
| Other Eurozone | – | 74 | 74 | – | – | – | 74 | 27 |
| Total Eurozone | 146 | 678 | 824 | 27 | 125 | 152 | 976 | 739 |
| United Kingdom | 909 | 850 | 1,759 | 2 | 433 | 435 | 2,194 | 1,938 |
| United States | – | 2,418 | 2,418 | 1 | 311 | 312 | 2,730 | 2,518 |
| Other, including Asia | 575 | 1,459 | 2,034 | 339 | 452 | 791 | 2,825 | 2,531 |
| Total | 1,630 | 5,405 | 7,035 | 369 | 1,321 | 1,690 | 8,725 | 7,726 |

The tables above exclude assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the tables above exclude the proportionate share of sovereign debt holdings of the Group's joint venture operations.

C3.3

Loans portfolio

(a)

Overview of loans portfolio

Loans are accounted for at amortised cost net of impairment except for:

–

Certain mortgage loans which have been designated at fair value through profit or loss of the UK and Europe insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and

–
Certain policy loans of the US insurance operations that are held to back liabilities for funds withheld under reinsurance arrangements and are also accounted on a fair value basis.

The amounts included in the statement of financial position are analysed as follows:

| | 31 Dec 2018 £m | | | | 31 Dec 2017 £m | | | |
|-------------------------------|-----------------|---------------|--------------|--------|-----------------|---------------|--------------|--------|
| | Mortgage loans* | Policy loans† | Other loans‡ | Total | Mortgage loans* | Policy loans† | Other loans‡ | Total |
| Asia | | | | | | | | |
| With-profits | – | 727 | 65 | 792 | – | 613 | 112 | 725 |
| Non-linked shareholder-backed | 156 | 226 | 203 | 585 | 177 | 216 | 199 | 592 |
| US | | | | | | | | |
| Non-linked shareholder-backed | 7,385 | 3,681 | – | 11,066 | 6,236 | 3,394 | – | 9,630 |
| UK and Europe | | | | | | | | |
| With-profits | 2,461 | 3 | 1,389 | 3,853 | 2,441 | 4 | 1,823 | 4,268 |
| Non-linked shareholder-backed | 1,655 | – | 59 | 1,714 | 1,681 | – | 37 | 1,718 |
| Other operations | – | – | – | – | – | – | 109 | 109 |
| Total loans securities | 11,657 | 4,637 | 1,716 | 18,010 | 10,535 | 4,227 | 2,280 | 17,042 |

*

All mortgage loans are secured by properties.

†

In the US £2,783 million (31 December 2017: £2,512 million) policy loans are backing liabilities for funds withheld under reinsurance arrangements and are accounted for at fair value through profit or loss. All other policy loans are accounted for at amortised cost, less any impairment.

‡

Other loans held in UK with-profits funds are commercial loans and comprise mainly syndicated loans.

(b)

Additional information on US mortgage loans

In the US, mortgage loans are all commercial mortgage loans that are secured by the following property types: industrial, multi-family residential, suburban office, retail or hotel. The average loan size is £14.0 million (2017: £12.6 million). The portfolio has a current estimated average loan to value of 53 per cent (2017: 55 per cent).

Jackson had no mortgage loans where the contractual terms of the agreements had been restructured at the end of both 2018 and 2017.

(c)

Additional information on UK mortgage loans

The UK with-profits fund invests in an entity that holds a portfolio of buy-to-let mortgage loans. The vehicle financed its acquisitions through the issue of debt instruments, largely to external parties, securitised upon the loans acquired. These third-party borrowings have no recourse to any other assets of the Group and the Group's exposure is limited to the amount invested by the UK with-profits fund.

By carrying value, £1,237 million of the £1,655 million (31 December 2017: £1,267 million of £1,681 million) mortgage loans held by the UK shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 33 per cent (31 December 2017: 31 per cent).

C4

Policyholder liabilities and unallocated surplus

The note provides information of policyholder liabilities and unallocated surplus of with-profits funds held on the Group's statement of financial position:

C4.1

Movement and duration of liabilities

C4.1(a)

Group overview

(i)

Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

| | Asia £m note C4.1(b) | US £m note C4.1(c) | UK and Europe £m note C4.1(d) | Total £m |
|--|-------------------------------|--------------------------|--|-------------|
| At 1 January 2017 | 62,784 | 177,626 | 169,304 | 409,714 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position note (i) | 53,716 | 177,626 | 157,654 | 388,996 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 2,667 | – | 11,650 | 14,317 |
| – Group's share of policyholder liabilities of joint ventures and associate note (ii) | 6,401 | – | – | 6,401 |
| Premiums | 11,863 | 15,219 | 14,810 | 41,892 |
| Surrenders | (3,079) | (10,017) | (6,939) | (20,035) |
| Maturities/deaths | (1,909) | (2,065) | (7,135) | (11,109) |
| Net flows | 6,875 | 3,137 | 736 | 10,748 |
| Shareholders' transfers post-tax | (54) | – | (233) | (287) |
| Investment-related items and other movements | 8,182 | 16,251 | 11,146 | 35,579 |
| Foreign exchange translation differences | (3,948) | (16,290) | 113 | (20,125) |
| At 31 December 2017/1 January 2018 | 73,839 | 180,724 | 181,066 | 435,629 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position note (i) (excludes £32 million classified as unallocated to a segment) | 62,898 | 180,724 | 167,589 | 411,211 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 3,474 | – | 13,477 | 16,951 |
| – Group's share of policyholder liabilities of joint ventures and associate note (ii) | 7,467 | – | – | 7,467 |
| Reclassification of reinsured UK annuity contracts as held for sale note (iii) | – | – | (10,858) | (10,858) |
| Premiums | 13,187 | 13,940 | 14,011 | 41,138 |
| Surrenders | (2,793) | (12,141) | (6,780) | (21,714) |
| Maturities/deaths | (1,978) | (2,012) | (6,796) | (10,786) |

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| | | | | |
|---|---------|---------|---------|----------|
| Net flows | 8,416 | (213) | 435 | 8,638 |
| Addition for closed block of group payout annuities in the USnote (iv)– | | 4,143 | – | 4,143 |
| Shareholders' transfers post-tax | (65) | – | (259) | (324) |
| Investment-related items and other movements | (2,784) | (9,999) | (5,481) | (18,264) |
| Foreign exchange translation differences | 3,357 | 10,945 | (14) | 14,288 |
| At 31 December 2018 | 82,763 | 185,600 | 164,889 | 433,252 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial positionnote (i) (excludes £39 million classified as unallocated to a segment) | 72,107 | 185,600 | 151,555 | 409,262 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 2,511 | – | 13,334 | 15,845 |
| – Group's share of policyholder liabilities of joint ventures and associatenote (ii) | 8,145 | – | – | 8,145 |
| Average policyholder liability balancesnote (v) | | | | |
| 2018 | 75,309 | 182,126 | 162,287 | 419,722 |
| 2017 | 65,241 | 179,175 | 162,622 | 407,038 |

Notes

(i)

The policyholder liabilities of the Asia insurance operations of £72,107 million (31 December 2017: £62,898 million), shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK and Europe insurance operations of £1,109 million (31 December 2017: £1,235 million) to the Hong Kong with-profits business. Including this amount total Asia policyholder liabilities are £73,216 million (31 December 2017: £64,133 million).

(ii)

The Group's investments in joint ventures and associate are accounted for on an equity method basis in the Group's balance sheet. The Group's share of the policyholder liabilities as shown above relate to life businesses in China, India and of the Takaful business in Malaysia.

(iii)

The reclassification as held for sale of the reinsured UK annuity business that will be transferred to Rothesay life once the Part VII process is complete reflects the value of policyholder liabilities held at 1 January 2018.

(iv)

In October 2018, Jackson entered into an agreement with John Hancock Life to reinsure 100 per cent of the group payout annuity business. The transaction resulted in an increase to policyholder liabilities of Jackson £4.1 billion at the inception of the contract.

(v)

Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions arising in the year and exclude unallocated surplus of with-profits funds.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the year but exclude liabilities that have not been allocated to a reporting segment. The items above are shown gross of external reinsurance.

The analysis includes the impact of premiums, claims and investment movements on policyholders' liabilities. The impact does not represent premiums, claims and investment movements as reported in the income statement. For example, the premiums shown above will exclude any deductions for fees/charges. Claims (surrenders, maturities and deaths) represent the policyholder liabilities provision released rather than the claim amount paid to the policyholder.

(ii)

Analysis of movements in policyholder liabilities for shareholder-backed business

| | Asia | US | UK and Europe | Total |
|--|---------|----------|------------------|----------|
| | £m | £m | £m | £m |
| At 1 January 2017 | 32,851 | 177,626 | 56,158 | 266,635 |
| Premiums | 6,064 | 15,219 | 2,283 | 23,566 |
| Surrenders | (2,755) | (10,017) | (2,433) | (15,205) |
| Maturities/deaths | (1,008) | (2,065) | (2,571) | (5,644) |
| Net flowsnote (i) | 2,301 | 3,137 | (2,721) | 2,717 |
| Investment-related items and other movements | 3,797 | 16,251 | 2,930 | 22,978 |
| Foreign exchange translation differences | (1,547) | (16,290) | – | (17,837) |
| At 31 December 2017/1 January 2018 | 37,402 | 180,724 | 56,367 | 274,493 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position (excludes £32 million classified as unallocated to a segment) | 29,935 | 180,724 | 56,367 | 267,026 |
| - Group's share of policyholder liabilities relating to joint ventures and associate | 7,467 | – | – | 7,467 |
| Reclassification of reinsured UK annuity contracts as held for sale note (ii) | – | – | (10,858) | (10,858) |
| Premiums | 6,752 | 13,940 | 1,486 | 22,178 |
| Surrenders | (2,455) | (12,141) | (2,016) | (16,612) |
| Maturities/deaths | (1,046) | (2,012) | (2,244) | (5,302) |
| Net flowsnote (i) | 3,251 | (213) | (2,774) | 264 |
| Addition for closed block of group payout annuities in the USnote (iii) | – | 4,143 | – | 4,143 |
| Investment-related items and other movements | (1,204) | (9,999) | (1,975) | (13,178) |
| Foreign exchange translation differences | 1,148 | 10,945 | – | 12,093 |
| At 31 December 2018 | 40,597 | 185,600 | 40,760 | 266,957 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position (excludes £39 million classified as unallocated to a segment) | 32,452 | 185,600 | 40,760 | 258,812 |
| - Group's share of policyholder liabilities relating to joint ventures and associate | 8,145 | – | – | 8,145 |

Notes

(i)

Including net flows of the Group's insurance joint ventures and associate.

(ii)

The reclassification as held for sale of the reinsured UK annuity business that will be transferred to Rothesay life once the Part VII process is complete reflects those policyholder liabilities held at 1 January 2018.

(iii)

In October 2018, Jackson entered into an agreement with John Hancock Life to reinsure 100 per cent of the group payout annuity business. The transaction resulted in an increase to policyholder liabilities of Jackson £4.1 billion at the inception of the contract.

C4.1(b)

Asia insurance operations

(i)

Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

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A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of Asia insurance operations from the beginning of the year to the end of the year is as follows:

| | With-profits business £m note (vi) | Unit-linked liabilities £m | Other business £m | Total £m |
|---|---|----------------------------------|-------------------------|-------------|
| At 1 January 2017 | 29,933 | 17,507 | 15,344 | 62,784 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position | 27,266 | 14,289 | 12,161 | 53,716 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 2,667 | - | - | 2,667 |
| – Group's share of policyholder liabilities relating to joint ventures and associate note (i) | - | 3,218 | 3,183 | 6,401 |
| Premiums | | | | |
| New business | 1,143 | 1,298 | 999 | 3,440 |
| In-force | 4,656 | 1,637 | 2,130 | 8,423 |
| | 5,799 | 2,935 | 3,129 | 11,863 |
| Surrenders note (ii) | (324) | (2,288) | (467) | (3,079) |
| Maturities/deaths | (901) | (150) | (858) | (1,909) |
| Net flows note (iii) | 4,574 | 497 | 1,804 | 6,875 |
| Shareholders' transfers post-tax | (54) | - | - | (54) |
| Investment-related items and other movements | 4,385 | 2,830 | 967 | 8,182 |
| Foreign exchange translation differences note (v) | (2,401) | (807) | (740) | (3,948) |
| At 31 December 2017/1 January 2018 | 36,437 | 20,027 | 17,375 | 73,839 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position | 32,963 | 16,263 | 13,672 | 62,898 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 3,474 | - | - | 3,474 |
| – Group's share of policyholder liabilities relating to joint ventures and associate note (i) | - | 3,764 | 3,703 | 7,467 |
| Premiums | | | | |
| New business | 1,155 | 1,426 | 1,085 | 3,666 |
| In-force | 5,280 | 1,767 | 2,474 | 9,521 |
| | 6,435 | 3,193 | 3,559 | 13,187 |
| Surrenders note (ii) | (338) | (1,904) | (551) | (2,793) |
| Maturities/deaths | (932) | (140) | (906) | (1,978) |
| Net flows note (iii) | 5,165 | 1,149 | 2,102 | 8,416 |
| Shareholders' transfers post-tax | (65) | - | - | (65) |
| Investment-related items and other movements note (iv) | (1,580) | (1,425) | 221 | (2,784) |
| Foreign exchange translation differences note (v) | 2,209 | 431 | 717 | 3,357 |
| At 31 December 2018 | 42,166 | 20,182 | 20,415 | 82,763 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position | 39,655 | 16,368 | 16,084 | 72,107 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 2,511 | - | - | 2,511 |

| | | | | |
|--|--------|--------|--------|--------|
| – Group's share of policyholder liabilities relating to joint ventures and associatenote (i) | – | 3,814 | 4,331 | 8,145 |
| Average policyholder liability balancesnote (vii) | | | | |
| 2018 | 36,309 | 20,105 | 18,895 | 75,309 |
| 2017 | 30,115 | 18,767 | 16,359 | 65,241 |

Notes

(i)
The Group's investment in joint ventures are accounted for on an equity method and the Group's share of the policyholder liabilities as shown above relate to the life business in China, India and of the Takaful business in Malaysia.

(ii)
The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 6.6 per cent in 2018 (2017: 8.4 per cent).

(iii)
Net flows have increased by £1,541 million to £8,416 million in 2018 predominantly reflecting continued growth of the in-force book.

(iv)
Investment-related items and other movements for 2018 primarily represent unrealised investments losses following unfavourable equity markets in the year and rising interest rates.

(v)
Movements in the year have been translated at the average exchange rates for the year. The closing balance has been translated at the closing spot rates as at the end of the year. Differences upon retranslation are included in foreign exchange translation differences.

(vi)
The policyholder liabilities of the with-profits business of £39,655 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK and Europe insurance operations of £1,109 million to the Hong Kong with-profits business (31 December 2017: £1,235 million). Including this amount the Asia with-profits policyholder liabilities are £40,764 million (31 December 2017: £34,198 million).

(vii)
Averages have been based on opening and closing balances and exclude unallocated surplus of with-profits funds.

(ii)
Duration of liabilities

The table below shows the carrying value of policyholder liabilities and the maturity profile of the cash flows on a discounted basis, taking account of expected future premiums and investment returns:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--------------------------|----------------|----------------|
| Policyholder liabilities | 72,107 | 62,898 |
| Expected maturity: | 31 Dec 2018 % | 31 Dec 2017 % |
| 0 to 5 years | 20 | 21 |
| 5 to 10 years | 19 | 19 |
| 10 to 15 years | 15 | 16 |
| 15 to 20 years | 12 | 12 |
| 20 to 25 years | 10 | 10 |
| Over 25 years | 24 | 22 |

C4.1(c)

US insurance operations

(i)

Analysis of movements in policyholder liabilities

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the year to the end of the year is as follows:

US insurance operations

| | Variable annuity separate account liabilities £m | Fixed annuity, GICs and other business £m | Total £m |
|--|---|--|-------------|
| At 1 | | | |
| January 2017 | 120,411 | 57,215 | 177,626 |
| Premiums | 11,529 | 3,690 | 15,219 |
| Surrenders | (6,997) | (3,020) | (10,017) |
| Maturities | (1,036) | (1,039) | (2,065) |
| Net flows | 3,506 | (369) | 3,137 |
| (ii) | | | |
| Transfers from general to separate account | 2,096 | (2,096) | – |
| Investment-related items and other movements | 15,956 | 295 | 16,251 |
| Foreign exchange translation differences | (11,441) | (4,849) | (16,290) |
| (i) | | | |
| At 31 December 2017/1 January 2018 | 130,528 | 50,196 | 180,724 |
| Premiums | 10,969 | 2,971 | 13,940 |
| Surrenders | (8,797) | (3,344) | (12,141) |
| Maturities | (1,085) | (927) | (2,012) |
| | 1,087 | (1,300) | (213) |

| | | | |
|--|----------|--------|---------|
| Net flowsnote (ii) Addition for closed block of group – | 4,143 | | 4,143 |
| payout annuities in the USnote (iii) Transfers from general | 530 | (530) | – |
| to separate account Investment-related items and other | (11,561) | 1,562 | (9,999) |
| movementsnote (iv) Foreign exchange translation | 7,636 | 3,309 | 10,945 |
| differencesnote (i) At 31 December | 128,220 | 57,380 | 185,600 |
| 2018 Average policyholder liability balancesnote (v) 2018 | 129,374 | 52,752 | 182,126 |
| 2017 | 125,469 | 53,706 | 179,175 |

Notes

(i)
Movements in the year have been translated at an average rate of US\$1.34: £1.00 (2017: US\$1.29: £1.00). The closing balances have been translated at closing rate of US\$1.27: £1.00 (2017: US\$1.35: £1.00). Differences upon retranslation are included in foreign exchange translation differences.

(ii)
Net outflows were £213 million (2017: inflows £3,137 million), with positive inflows to variable annuities business as new business exceeds withdrawals and surrenders offset by outflows from fixed annuity, GICs and other business as the portfolio matures.

(iii)

In October 2018, Jackson entered into an agreement with John Hancock Life to reinsure 100 per cent of the group payout annuity business. The transaction resulted in an increase to policyholder liabilities of Jackson £4.1 billion at the inception of the contract.

(iv)

Negative investment-related items and other movements in variable annuity separate account liabilities of £(11,561) million for 2018 primarily reflects the decrease in equity and bond values during the year. Fixed annuity, GIC and other business investment and other movements of £1,562 million primarily reflect the interest credited to the policyholder accounts and increase in the guarantee reserves in the year.

(v)

Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions arising in the year.

(ii)

Duration of liabilities

The table below shows the carrying value of policyholder liabilities and maturity profile of the cash flows on a discounted basis for 2018 and 2017:

| | 31 Dec 2018 | | | 31 Dec 2017 | | |
|--------------------------|---|---|---------|---|---|---------|
| | Fixed annuity and other business (including GICs and similar contracts) | Variable annuity separate account liabilities | Total | Fixed annuity and other business (including GICs and similar contracts) | Variable annuity separate account liabilities | Total |
| | £m | £m | £m | £m | £m | £m |
| Policyholder liabilities | 57,380 | 128,220 | 185,600 | 50,196 | 130,528 | 180,724 |
| Expected maturity: | % | % | % | % | % | % |
| 0 to 5 years | 51 | 40 | 43 | 50 | 42 | 44 |
| 5 to 10 years | 24 | 28 | 27 | 25 | 29 | 28 |
| 10 to 15 years | 12 | 16 | 15 | 12 | 15 | 14 |
| 15 to 20 years | 7 | 9 | 8 | 7 | 8 | 8 |
| 20 to 25 years | 3 | 4 | 4 | 3 | 4 | 4 |
| Over 25 years | 3 | 3 | 3 | 3 | 2 | 2 |

C4.1(d)

UK and Europe insurance operations

(i)

Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK and Europe insurance operations from the beginning of the year to the end of the year is as follows:

| | With-profits sub-funds | Shareholder-backed funds and subsidiaries | Total |
|--|------------------------|---|--------------------------------------|
| | | Unit-linked liabilities | Annuity and other long-term business |
| | | | |

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| | £m | £m | £m | £m |
|---|---------------------|---------|----------|----------|
| At 1 January 2017 | note (v) 113,146 | 22,119 | 34,039 | 169,304 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position | 101,496 | 22,119 | 34,039 | 157,654 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 11,650 | – | – | 11,650 |
| Premiums | 12,527 | 1,923 | 360 | 14,810 |
| Surrenders | (4,506) | (2,342) | (91) | (6,939) |
| Maturities/deaths | (4,564) | (612) | (1,959) | (7,135) |
| Net flowsnote (i) | 3,457 | (1,031) | (1,690) | 736 |
| Shareholders' transfers post-tax | (233) | – | – | (233) |
| Switches | (192) | 192 | – | – |
| Investment-related items and other movements | 8,408 | 1,865 | 873 | 11,146 |
| Foreign exchange translation differences | 113 | – | – | 113 |
| At 31 December 2017/1 January 2018 | 124,699 | 23,145 | 33,222 | 181,066 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position | 111,222 | 23,145 | 33,222 | 167,589 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 13,477 | – | – | 13,477 |
| Reclassification of reinsured UK annuity contracts as held for sale note (ii) | – | – | (10,858) | (10,858) |
| Premiums | 12,525 | 1,147 | 339 | 14,011 |
| Surrenders | (4,764) | (1,950) | (66) | (6,780) |
| Maturities/deaths | (4,552) | (619) | (1,625) | (6,796) |
| Net flowsnote (i) | 3,209 | (1,422) | (1,352) | 435 |
| Shareholders' transfers post-tax | (259) | – | – | (259) |
| Switches | (165) | 165 | – | – |
| Investment-related items and other movementsnote (iii) | (3,341) | (1,171) | (969) | (5,481) |
| Foreign exchange translation differences | (14) | – | – | (14) |
| At 31 December 2018 | 124,129 | 20,717 | 20,043 | 164,889 |
| Comprising: | | | | |
| – Policyholder liabilities on the consolidated statement of financial position | 110,795 | 20,717 | 20,043 | 151,555 |
| – Unallocated surplus of with-profits funds on the consolidated statement of financial position | 13,334 | – | – | 13,334 |
| Average policyholder liability balancesnote (iv) | | | | |
| 2018 | 111,009 | 21,931 | 29,347 | 162,287 |
| 2017 | 106,359 | 22,632 | 33,631 | 162,622 |

Notes

(i)

Net inflows were £435 million (31 December 2017: net inflows of £736 million). Inflows into the with-profits business were offset by outflows from both the annuity business, as the closed book matures, and the unit-linked business. The levels of inflows/outflows for the unit-linked business is driven by corporate pension schemes with transfers in or out from only a small number of schemes influencing the level of flows in the year.

(ii)

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The reclassification as held for sale of the reinsured UK annuity business that will be transferred to Rothesay life once the Part VII process is complete reflects the value policyholder liabilities held at 1 January 2018.

(iii)

Investment-related items and other movements for with-profits business principally comprise investment return attributable to policyholders reflecting falling equity markets in the later quarter of the year. For shareholder-backed annuity and other long-term business, investment-related items and other movements include the effect of movements in interest rates and credit spreads.

(iv)

Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions arising in the year and exclude unallocated surplus of with-profits funds.

(v)

Includes the Scottish Amicable Insurance Fund.

(ii)

Duration of liabilities

The following tables show the carrying value of the policyholder liabilities and the maturity profile of the cash flows, on a discounted basis:

| | 31 Dec 2018 £m | | | | | | | | | |
|--------------------------|-----------------------|----------------------|---------|---|----------------------------|--------|---------------------|-----------------------|--------|---------|
| | With-profits business | | | Annuity business (insurance contracts) | | Other | Total | | | Total |
| | Insurance contracts | Investment contracts | Total | Non-profit annuities within WPSF | Shareholder-backed annuity | | Insurance contracts | Investments contracts | Total | |
| Policyholder liabilities | 34,242 | 67,020 | 101,262 | 9,533 | 19,119 | 28,652 | 6,063 | 15,578 | 21,641 | 151,555 |
| | 31 Dec 2018 % | | | | | | | | | |
| Expected maturity: | | | | | | | | | | |
| 0 to 5 years | 34 | 37 | 36 | 33 | 27 | 29 | 44 | 32 | 36 | 35 |
| 5 to 10 years | 23 | 27 | 26 | 26 | 23 | 24 | 25 | 24 | 24 | 25 |
| 10 to 15 years | 16 | 17 | 17 | 17 | 19 | 18 | 15 | 18 | 17 | 17 |
| 15 to 20 years | 11 | 9 | 10 | 11 | 14 | 13 | 8 | 12 | 11 | 10 |
| 20 to 25 years | 7 | 4 | 5 | 6 | 9 | 8 | 4 | 7 | 6 | 6 |
| over 25 years | 9 | 6 | 6 | 7 | 8 | 8 | 4 | 7 | 6 | 7 |
| | 31 Dec 2017 £m | | | | | | | | | |
| Policyholder liabilities | 38,285 | 62,328 | 100,613 | 10,609 | 32,572 | 43,181 | 6,714 | 17,081 | 23,795 | 167,589 |
| | 31 Dec 2017 % | | | | | | | | | |
| Expected maturity: | | | | | | | | | | |
| 0 to 5 years | 33 | 37 | 36 | 31 | 26 | 27 | 41 | 31 | 34 | 34 |
| 5 to 10 years | 23 | 27 | 25 | 24 | 23 | 23 | 26 | 22 | 23 | 25 |
| | 16 | 17 | 17 | 17 | 18 | 18 | 15 | 18 | 17 | 17 |

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| | | | | | | | | | | |
|-------------------|----|----|----|----|----|----|---|----|----|----|
| 10 to 15 years | | | | | | | | | | |
| 15 to 20 years | 11 | 10 | 10 | 11 | 13 | 13 | 9 | 13 | 12 | 11 |
| 20 to 25 years | 7 | 4 | 5 | 7 | 9 | 9 | 5 | 8 | 7 | 6 |
| over 25 years | 10 | 5 | 7 | 10 | 11 | 10 | 4 | 8 | 7 | 7 |

—
The cash flow projections of expected benefit payments used in the maturity profile table above are from value of in-force business and exclude the value of future new business, including future vesting of internal pension contracts.

—
Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.

—
Shareholder-backed annuity business includes the ex-PRIL and the legacy PAC shareholder annuity business but excludes the amount classified as held for sale.

—
Investment contracts under 'Other' comprise certain unit-linked and similar contracts accounted for under IAS 39 and IFRS 15.

—
For business with no maturity term included within the contracts, for example, with-profits investment bonds such as Prudence Bonds, an assumption is made as to likely duration based on prior experience.

C5

Intangible assets

C5.1

Goodwill

| | 31 Dec 2018 £m | | 31 Dec 2017 £m | |
|---|------------------|--------------|-------------------|-------|
| | Attributable to: | | | |
| | Shareholders | With-profits | Total | Total |
| Carrying value at beginning of year | 1,458 | 24 | 1,482 | 1,628 |
| Acquisition of TMB Asset Management Co., Ltd. in Thailand (see note D1.2) | 181 | – | 181 | – |
| Other additions in the year (see below) | – | 195 | 195 | 9 |
| Disposals/reclassifications to held for sale | – | (10) | (10) | (155) |
| Exchange differences | 12 | (3) | 9 | – |
| Carrying value at end of year | 1,651 | 206 | 1,857 | 1,482 |
| Comprising: | | | | |
| M&G – attributable to shareholders | | | 1,153 | 1,153 |
| Other – attributable to shareholders | | | 498 | 305 |
| Goodwill – attributable to shareholders | | | 1,651 | 1,458 |
| Venture fund investments – attributable to with-profits funds | | | 206 | 24 |
| | | | 1,857 | 1,482 |

During 2018, the UK with-profits fund, via its venture fund holdings managed by M&G Prudential asset management, made a small number of acquisitions that are consolidated by the Group resulting in an addition to goodwill of £195 million. As these transactions are within the with-profits fund, they have no impact on shareholders' profit or equity for the year ended 31 December 2018. The impact on the Group's consolidated revenue, including investment returns, is not material. Had the acquisitions been effected at 1 January 2018, the revenue and profit of the Group for 2018 would not have been materially different.

C5.2

Deferred acquisition costs and other intangible assets

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Deferred acquisition costs and other intangible assets attributable to shareholders | 11,784 | 10,866 |
| Other intangible assets, including computer software, attributable to with-profits funds | 139 | 145 |
| Total of deferred acquisition costs and other intangible assets | 11,923 | 11,011 |

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

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|-------------------|-------------------|
| Deferred acquisition costs related to insurance contracts as classified under IFRS 4 | 10,017 | 9,170 |
| Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 | 78 | 63 |

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| | | |
|---|--------|--------|
| Deferred acquisition costs related to insurance and investment contracts | 10,095 | 9,233 |
| Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF) | 34 | 36 |
| Distribution rights and other intangibles | 1,655 | 1,597 |
| Present value of acquired in-force (PVIF) and other intangibles attributable to shareholders | 1,689 | 1,633 |
| Total of deferred acquisition costs and other intangible assetsnote (a) | 11,784 | 10,866 |

Notes

(a)

Total deferred acquisition costs and other intangible assets can be further analysed by business operations as follows:

| | 31 Dec 2018 £m | | | | | 31 Dec 2017 £m | |
|---|----------------------------|-----------------------|-------------------------|----------------------|-----------------------------|----------------|--------|
| | Deferred acquisition costs | | | | | Total | Total |
| | Asia insurance | US insurance note (b) | UK and Europe insurance | All asset management | PVIF and other intangibles* | | |
| Balance at 1 January | 946 | 8,197 | 84 | 6 | 1,633 | 10,866 | 10,755 |
| Additions | 419 | 569 | 15 | 15 | 230 | 1,248 | 1,240 |
| Amortisation to the income statement:note (c)† | | | | | | | |
| Adjusted IFRS operating profit based on longer-term investment returns | (148) | (683) | (11) | (3) | (179) | (1,024) | (709) |
| Non-operating profit | – | (114) | – | – | (4) | (118) | 455 |
| | (148) | (797) | (11) | (3) | (183) | (1,142) | (254) |
| Disposals and transfers | – | – | – | – | (14) | (14) | – |
| Exchange differences and other movements | 47 | 512 | (2) | – | 23 | 580 | (799) |
| Amortisation of DAC related to net unrealised valuation movements on the US insurance operation's available-for-sale securities recognised within other comprehensive income† | – | 246 | – | – | – | 246 | (76) |
| Balance at 31 December | 1,264 | 8,727 | 86 | 18 | 1,689 | 11,784 | 10,866 |

*

PVIF and other intangibles comprise PVIF, distribution rights and other intangibles such as software rights.

Distribution rights relate to amounts that have been paid or have become unconditionally due for payment as a result of past events in respect of bancassurance partnership arrangements in Asia. These agreements allow for bank distribution of Prudential's insurance products for a fixed period of time. Software rights include additions of £34 million, amortisation of £32 million, foreign exchange losses of £7 million and a balance at 31 December 2018 of £62 million.

†

Under the Group's application of IFRS 4, US GAAP is used for measuring the insurance assets and liabilities of its US and certain Asia operations. Under US GAAP, most of the US insurance operation's products are accounted for under Accounting Standards Codification Topic 944, Financial Services – Insurance, of the Financial Accounting Standards Board whereby deferred acquisition costs are amortised in line with the emergence of actual and expected gross profits which are determined using an assumption for long-term investment returns for the separate account of 7.4 per

cent (2017: 7.4 per cent) (gross of asset management fees and other charges to policyholders, but net of external fund management fees). The amounts included in the income statement and other comprehensive income affect the pattern of profit emergence and thus the DAC amortisation attaching. DAC amortisation is allocated to the operating and non-operating components of the Group's supplementary analysis of profit and other comprehensive income by reference to the underlying items (see note C7.3(iv)).

(b)

The DAC amount in respect of US insurance operations comprises amounts in respect of:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Variable annuity business | 8,477 | 8,208 |
| Other business | 299 | 278 |
| Cumulative shadow DAC (for unrealised gains booked in other comprehensive income)* | (49) | (289) |
| Total DAC for US operations | 8,727 | 8,197 |

*

A gain of £246 million (2017: a loss of £(76) million) for shadow DAC amortisation is booked within other comprehensive income to reflect the impact from the negative unrealised valuation movement in 2018 of £1,617 million (2017: positive unrealised valuation movement of £617 million). These adjustments reflect movement from period to period, in the changes to the pattern of reported gross profits that would have occurred if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 31 December 2018, the cumulative shadow DAC balance as shown in the table above was negative £49 million (31 December 2017: negative £289 million).

(c)

Sensitivity of amortisation charge

The amortisation charge to the income statement is reflected in both adjusted IFRS operating profit based on longer-term investment returns and short-term fluctuations in investment returns. The amortisation charge to adjusted IFRS operating profit based on longer-term investment returns in a reporting period comprises:

—

A core amount that reflects a relatively stable proportion of underlying premiums or profit; and

—

An element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique (which is used for moderating the effect of short-term volatility in investment returns) are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

Furthermore, in those periods where the cap or floor is relevant, the mean reversion technique provides no further dampening and additional volatility may result.

In 2018, the DAC amortisation charge for adjusted IFRS operating profit based on longer-term investment returns was determined after including a debit for accelerated amortisation of £194 million (2017: credit for decelerated amortisation of £86 million). The acceleration arising in 2018 reflects a mechanical increase in the projected separate account return for the next five years under the mean-reversion technique. Under this technique the projected level of return for each of the next five years is adjusted so that in combination with the actual rates of return for the preceding three years (including the current period) the assumed long-term annual separate account return of 7.4 per cent is realised on average over the entire eight-year period. The acceleration in DAC amortisation in 2018 is driven both by

the actual separate return in the year being lower than that assumed and by the lower than expected return in 2015 falling out of the eight-year period in effect reversing the deceleration experienced in 2015 under the mean reversion formula.

The application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation while the mean reversion assumption lies within the corridor. At 31 December 2018, it would take approximate movements in separate account values of more than either negative 22 per cent or positive 57 per cent (31 December 2017: negative 32 per cent or positive 37 per cent) for the mean reversion assumption to move outside the corridor.

C6

Borrowings

C6.1

Core structural borrowings of shareholder-financed businesses

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Holding company operations:note (i) | | |
| Perpetual Subordinated Capital Securities (Tier 1) | 431 | 814 |
| Perpetual Subordinated Capital Securities (Tier 2)note (v) | 2,478 | 2,326 |
| Subordinated Notes (Tier 2)note (iv) | 3,767 | 2,132 |
| Subordinated debt total | 6,676 | 5,272 |
| Senior debt:note (ii) | | |
| £300m 6.875% Bonds 2023 | 294 | 300 |
| £250m 5.875% Bonds 2029 | 223 | 249 |
| Bank loannote (iii) | 275 | – |
| Holding company total | 7,468 | 5,821 |
| Prudential Capital bank loannote (iii) | – | 275 |
| Jackson US\$250m 8.15% Surplus Notes 2027 | 196 | 184 |
| Total (per consolidated statement of financial position) | 7,664 | 6,280 |

Notes

(i)

These debt tier classifications are consistent with the treatment of capital for regulatory purposes under the Solvency II regime.

The Group has designated US\$3,725 million (31 December 2017: US\$4,275 million) of its US dollar denominated subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.

(ii)

The senior debt ranks above subordinated debt in the event of liquidation. In 2018, as part of its preparation to demerge M&GPrudential, the Group made certain modifications to the terms and conditions of the senior bonds with bondholders' consent. The amendment to the terms and conditions will avoid an event of a technical default on the

bonds, should the demerger proceed. The fees paid to bondholders have been adjusted to the carrying value of the bonds and will be amortised in subsequent periods. No other adjustments were made to the carrying value of the debt as a result of the modification.

(iii)

The bank loan of £275 million is drawn at a cost of 12-month GBP LIBOR plus 0.33 per cent. The loan, held by Prudential Capital as of 31 December 2017, was renewed in December 2018, with Prudential plc becoming the new holder. The loan matures on 20 December 2022 with an option to repay annually.

(iv)

In October 2018, the Company issued the following three substitutable core structural borrowings as part of the process required before demerger to rebalance debt across M&GPrudential and Prudential (see below):

-
£750 million 5.625 per cent Tier 2 subordinated notes due 2051. The proceeds, net of costs, were £743 million;

-
£500 million 6.25 per cent Tier 2 subordinated notes due 2068. The proceeds, net of costs, were £498 million; and

-
US\$500 million 6.5 per cent Tier 2 subordinated notes due 2048. The proceeds, net of costs, were £389 million (US\$498 million).

(v)

In December 2018, the Company paid £434 million to redeem its US\$550 million 7.75 per cent Tier 1 perpetual subordinated notes.

Prior to the demerger, the Group expects to rebalance its debt capital across Prudential and M&GPrudential. This will include the ultimate holding company of M&GPrudential becoming an issuer of new debt, including debt substituted from Prudential, and Prudential redeeming some of its existing debt. Following these actions, the overall absolute quantum of debt across Prudential and M&GPrudential is currently expected to increase, by an amount which is not considered to be material in the context of the Group's total outstanding debt as at 30 June 2018, before any substitutable debt had been issued, of £7.6 billion (comprising the Group's core structural borrowings of £6.4 billion and shareholder borrowings from short-term fixed income securities programme of £1.2 billion). At the time of the demerger, Prudential expects M&GPrudential to be holding around £3.5 billion of subordinated debt. This expectation is subject to the M&GPrudential capital risk appetite being approved by the Board of the ultimate holding company of M&GPrudential, once fully constituted to include independent non-executive directors, and reflects the current operating environment and economic conditions, material changes in which may lead to a different outcome.

Ratings

Prudential plc has debt ratings from Standard & Poor's, Moody's and Fitch. Prudential plc's long-term senior debt is rated A2 by Moody's, A by Standard & Poor's and A- by Fitch.

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

The financial strength of The Prudential Assurance Company Limited is rated A+ by Standard & Poor's, Aa3 by Moody's and AA- by Fitch.

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

Prudential Assurance Co. Singapore (Pte) Ltd.'s (Prudential Singapore) financial strength is rated AA- by Standard & Poor's.

All the Group's ratings are on a stable outlook.

Other borrowings

(i)

Operational borrowings attributable to shareholder-financed businesses

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Borrowings in respect of short-term fixed income securities programmes | 472 | 1,085 |
| Other borrowings note | 526 | 706 |
| Total | 998 | 1,791 |

Note

Other borrowings mainly include senior debt issued through the Federal Home Loan Bank of Indianapolis (FHLB), secured by collateral posted with the FHLB by Jackson. In addition, other borrowings include amounts whose repayment to the lender is contingent upon future surplus emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(ii)

Borrowings attributable to with-profits businesses

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|--|----------------|----------------|
| Non-recourse borrowings of consolidated investment funds* | 3,845 | 3,570 |
| £100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc† | – | 100 |
| Other borrowings (including obligations under finance leases) | 95 | 46 |
| Total | 3,940 | 3,716 |

*

In all instances the holders of the debt instruments issued by these subsidiaries and funds do not have recourse beyond the assets of these subsidiaries and funds.

†

The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinated to the entitlements of the policyholders of that fund. These bonds were redeemed in full on 30 June 2018.

C7

Risk and sensitivity analysis

C7.1

Group overview

The Group’s risk framework and the management of the risk, including those attached to the Group’s financial statements including financial assets, financial liabilities and insurance liabilities, together with the inter-relationship with the management of capital have been included in the ‘Chief Risk Officer’s Report on the risks facing our business and how these are managed’.

The financial and insurance assets and liabilities on the Group’s balance sheet are, to varying degrees, subject to market and insurance risk and other changes of experience assumptions that may have a material effect on IFRS basis profit or loss and shareholders’ equity. The market and insurance risks, including how they affect Group’s operations and how these are managed are discussed in the Risk report referred to above.

The most significant items that the IFRS shareholders’ profit or loss and shareholders’ equity for the Group’s life assurance business are sensitive to, are shown in the following tables. The distinction between direct and indirect exposure is not intended to indicate the relative size of the sensitivity.

| Type of business | Market and credit risk Liabilities/unallocated investments/derivatives surplus | Insurance and lapse risk |
|---|--|---|
| Asia insurance operations (see also section C7.2) | | |
| All business | Currency risk | Mortality and morbidity risk Persistence risk |
| With-profits business | Net neutral direct exposure (indirect exposure only) | Investment performance subject to smoothing through declared bonuses |
| Unit-linked business | Net neutral direct exposure (indirect exposure only) | Investment performance through asset management fees |
| Non-participating business | Asset/liability mismatch risk Credit rates for these operations where the basis of insurance liabilities is | |

sensitive to
current market
movements
Interest
rate
and
price
risk

US insurance operations (see also section C7.3)

All business

Currency risk
Net effect of
market risk
arising from
incidence of
guarantee
features and
variability of
asset
management fees
offset by
derivative
hedging
programme

Persistency risk

Variable annuity business

Risk that utilisation
of withdrawal
benefits or lapse
levels differ from
those assumed in
pricing

Fixed index annuity business

Derivative
hedge
programme
Incidence of
to
equity
the
participation
extent
features
not
fully
hedged
against
liability

Fixed index annuities, Fixed
annuities and GIC business

Credit
risk
Interest
rate
risk
Profit
and
loss
and
shareholders'
equity
are

Spread difference
between earned
rate and rate
credited
to policyholders

Lapse risk, but the
effects of extreme
events may be
mitigated
by the application
of
market value
adjustments

volatile
for
these
risks
as
they
affect
the
values
of
derivatives
and
embedded
derivatives
and
impairment
losses.
In
addition,
shareholders'
equity
is
volatile
for
the
incidence
of
these
risks
on
unrealised
appreciation
of
fixed
income
securities
classified
as
available-for-sale
under
IAS
39

UK and Europe insurance operations (see also section
C7.4)

With-profits business

Net neutral direct Investment performance subject to
exposure smoothing through declared bonuses
(indirect

Persistency risk to
future shareholder
transfers

exposure only)

| | | | |
|-------------------------------------|--|--|--|
| SAIF sub-fund | Net neutral direct exposure (indirect exposure only) | Asset management fees earned | |
| Unit-linked business | Net neutral direct exposure (indirect exposure only) | Investment performance through asset management fees | Persistency risk |
| Shareholder-backed annuity business | Asset/liability mismatch risk Credit risk for assets covering liabilities and shareholder capital | | Mortality experience and assumptions for longevity |
| | Interest rate risk for assets in excess of liabilities, ie assets representing shareholder capital | | |

Detailed analyses of sensitivity of IFRS basis profit or loss and shareholders' equity to key market and other risks by business unit are provided in notes C7.2, C7.3, C7.4 and C7.5. The sensitivity analyses provided show the effect on profit or loss and shareholders' equity to changes in the relevant risk variables, all of which are reasonably possible at the relevant balance sheet date. In the equity risk sensitivity analysis shown below, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather would be expected to occur over a period of time during which the Group would be able to put mitigating management actions in place. In addition, the equity risk

sensitivity analysis provided assumed that all equity indices fall by the same percentage.

Impact of diversification on risk exposure

The Group benefits from diversification benefits achieved through the geographical spread of the Group's operations and, within those operations, through a broad mix of product types. Relevant correlation factors include:

Correlation across geographic regions:

—

Financial risk factors; and

—

Non-financial risk factors.

Correlation across risk factors:

—

Longevity risk;

—

Expenses;

—

Persistency; and

—

Other risks.

The sensitivities below do not reflect that assets and liabilities are actively managed and may vary at the time any actual market movement occurs. There are strategies in place to minimise the exposure to market fluctuations. For example, as market indices fluctuate, Prudential would take certain actions including selling investments, changing investment portfolio allocation and adjusting bonuses credited to policyholders. In addition, these analyses do not consider the effect of market changes on new business generated in the future.

Other limitations on the sensitivities include: the use of hypothetical market movements to demonstrate potential risk that only represent Prudential's view of reasonably possible near-term market changes and that cannot be predicted with any certainty; the assumption that interest rates in all countries move identically; the assumption that all global currencies move in tandem with the US dollar against pound sterling; and the lack of consideration of the inter-relation of interest rates, equity markets and foreign currency exchange rates.

C7.2

Asia insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks

The Asia operations sell with-profits and unit-linked policies, and the investment portfolio of the with-profits funds contains a proportion of equities. Non-participating business is largely backed by debt securities or deposits. The Group's exposure to market risk arising from its Asia operations is therefore at modest levels. This reflects the fact that the Asia operations have a balanced portfolio of with-profits, unit-linked and other types of business.

In Asia, adverse persistency experience can impact the IFRS profitability of certain types of business written in the region. This risk is managed at a business unit level through regular monitoring of experience and the implementation of management actions as necessary. These actions could include product enhancements, increased management focus on premium collection, as well as other customer retention efforts. The potential financial impact of lapses is often mitigated through the specific features of the products, eg surrender charges, or through the availability of premium holiday or partial withdrawal policy features.

In summary, for Asia operations, the adjusted IFRS operating profit based on longer-term investment returns is mainly affected by the impact of market levels on unit-linked persistency, and other insurance risks. At the total IFRS profit

level the Asia result is affected by short-term value movements on the asset portfolio for non-linked shareholder-backed business.

(i)

Sensitivity to risks other than foreign exchange risk

Interest rate risk

Excluding its with-profits and unit-linked businesses, the results of the Asia business are sensitive to the movements in interest rates.

For the purposes of analysing sensitivity to variations in interest rates, reference has been made to the movements in the 10-year government bond rates of the territories. At 31 December 2018, 10-year government bond rates vary from territory to territory and range from 0.9 per cent to 8.1 per cent (31 December 2017: 1.0 per cent to 7.5 per cent).

For the sensitivity analysis as shown in the table below, the reasonably possible interest rate movement used is 1 per cent for all local business units.

The estimated sensitivity to the decrease and increase in interest rates is as follows:

| | 2018 £m | | 2017 £m | |
|--|-------------------|-------------------|-------------------|-------------------|
| | Decrease of 1% | Increase of 1% | Decrease of 1% | Increase of 1% |
| Profit before tax attributable to shareholders | 312 | (338) | 2 | (443) |
| Related deferred tax (where applicable) | (15) | 26 | (7) | 20 |
| Net effect on profit and shareholders' equity | 297 | (312) | (5) | (423) |

The pre-tax impacts, if they arose, would mostly be recorded within the category short-term fluctuations in investments returns in the Group's segmental analysis of profit before tax.

The degree of sensitivity of the results of the non-linked shareholder-backed business of the Asia operations to movements in interest rates depends upon the degree to which the liabilities under the 'grandfathered' IFRS 4 measurement basis reflects market interest rates from period-to-period. For example for countries applying US GAAP the results can be more sensitive as the effect of interest rate movements on the backing investments may not be offset by liability movements.

In addition, the degree of sensitivity of the results shown in the table above is dependent on the interest rate level at that point of time.

An additional factor to the direction of the sensitivity of the Asia operations as a whole is movement in the country mix.

Equity price risk

The non-linked shareholder-backed business has limited exposure to equity and property investment (31 December 2018: £2,151 million; 31 December 2017: £1,764 million). Generally, changes in equity and property investment values are not directly offset by movements in non-linked policyholder liabilities.

The estimated sensitivity to a 10 per cent and 20 per cent change in equity and property prices for shareholder-backed Asia other business (including those held by the Group's joint venture and associate businesses), which would be reflected in the short-term fluctuation component of the Group's segmental analysis of profit before tax, is as follows:

| 2018 £m | 2017 £m |
|----------|----------|
| Decrease | Decrease |

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| | of 20% | of 10% | of 20% | of 10% |
|--|--------|--------|--------|--------|
| Profit before tax attributable to shareholders | (557) | (279) | (478) | (239) |
| Related deferred tax (where applicable) | 17 | 8 | 7 | 4 |
| Net effect on profit and shareholders' equity | (540) | (271) | (471) | (235) |

A 10 or 20 per cent increase in equity and property values would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above.

Insurance risk

Many of the business units in Asia are exposed to mortality/morbidity risk and provision is made within policyholder liabilities on a prudent regulatory basis to cover the potential exposure. If these prudent assumptions were strengthened by 5 per cent then it is estimated that post-tax profit and shareholders' equity would be decreased by approximately £57 million (2017: £66 million). Mortality and morbidity have a broadly symmetrical effect on the portfolio and any weakening of these assumptions would have a similar equal and opposite impact.

(ii)

Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Asia insurance operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2018, the rates for the most significant operations are given in note A1.

A 10 per cent increase (strengthening of the pound sterling) or decrease (weakening of the pound sterling) in these rates would have reduced or increased profit before tax attributable to shareholders, profit for the year and shareholders' equity, excluding goodwill attributable to Asia insurance operations respectively as follows:

| | A 10% increase in local currency to £ exchange rates | | A 10% decrease in local currency to £ exchange rates | |
|---|--|---------|--|---------|
| | 2018 £m | 2017 £m | 2018 £m | 2017 £m |
| Profit before tax attributable to shareholders | (134) | (155) | 164 | 189 |
| Profit for the year | (113) | (135) | 138 | 165 |
| Shareholders' equity, excluding goodwill, attributable to Asia operations | (543) | (492) | 664 | 601 |

C7.3

US insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks

Jackson's reported adjusted IFRS operating profit based on longer-term investment returns is sensitive to market conditions, both with respect to income earned on spread-based products and indirectly with respect to income earned on variable annuity asset management fees. Jackson's main exposures to market risk are to interest rate risk and equity risk.

Jackson is exposed primarily to the following risks:

Risks Risk of loss

Equity risk Related to the incidence of benefits related to guarantees issued in connection with its variable annuity contracts; and

–Related to meeting contractual accumulation requirements in fixed index annuity contracts.

Interest rate risk Related to meeting guaranteed rates of accumulation on fixed annuity products following a sustained fall in interest rates;

Related to increases in the present value of projected benefits related to guarantees issued in connection with its variable annuity contracts following a sustained fall in interest rates especially if in conjunction with a fall in equity markets;

Related to the surrender value guarantee features attached to the Company's fixed annuity products and to policyholder withdrawals following a sharp and sustained increase in interest rates; and

The risk of mismatch between the expected duration of certain annuity liabilities and prepayment risk and extension risk inherent in mortgage-backed securities.

Jackson's derivative programme is used to manage interest rate risk associated with a broad range of products and equity market risk attaching to its equity-based products. Movements in equity markets, equity volatility, interest rates and credit spreads materially affect the carrying value of derivatives that are used to manage the liabilities to policyholders and backing investment assets. Movements in the carrying value of derivatives combined with the use of US GAAP measurement (as 'grandfathered' under IFRS 4) for the insurance contracts assets and liabilities, which is largely insensitive to current period market movements, mean that the Jackson total profit (ie including short-term fluctuations in investment returns) is sensitive to market movements. In addition to these effects the Jackson shareholders' equity is sensitive to the impact of interest rate and credit spread movements on the value of fixed income securities. Movements in unrealised appreciation on these securities are included as movement in shareholders' equity (ie outside the income statement).

Jackson enters into financial derivative transactions, including those noted below, to reduce and manage business risks. These transactions manage the risk of a change in the value, yield, price, cash flows or quantity of, or a degree of exposure, with respect to assets, liabilities or future cash flows, which Jackson has acquired or incurred.

Jackson uses free-standing derivative instruments for hedging purposes. Additionally, certain liabilities, primarily trust instruments supported by funding agreements, fixed index annuities, certain variable annuity guaranteed benefit features and reinsured Guaranteed Minimum Income Benefit variable annuity features are similar to derivatives. Jackson does not account for such items as either fair value or cash flow hedges as might be permitted if the specific hedge documentation requirements of IAS 39 were followed. Financial derivatives are carried at fair value, including derivatives embedded in certain host liabilities where these are required to be valued separately.

The principal types of derivatives used by Jackson and their purpose are as follows:

| Derivative | Purpose |
|---|---|
| Interest rate swaps | These generally involve the exchange of fixed and floating payments over the period for which Jackson holds the instrument without an exchange of the underlying principal amount. These agreements are used to hedge Jackson's exposure to movements in interest rates. |
| Swaption contracts | These contracts provide the purchaser with the right, but not the obligation, to require the writer to pay the present value of a long-duration interest rate swap at future exercise dates. Jackson both purchases and writes swaptions in order to hedge against significant movements in interest rates. |
| Treasury futures contracts | These derivatives are used to hedge Jackson's exposure to movements in interest rates. |
| Equity index futures contracts and equity index options | These derivatives (including various call and put options and options contingent on interest rates and currency exchange rates) are used to hedge Jackson's obligations associated with its issuance of certain VA guarantees. Some of these annuities and guarantees contain embedded options that are fair valued for financial reporting purposes. |
| Cross-currency swaps | Cross-currency swaps, which embody spot and forward currency swaps and additionally, in some cases, interest rate swaps and equity index swaps, are entered into for the purpose of hedging Jackson's foreign currency denominated funding agreements supporting trust instrument obligations. |
| Credit default swaps | |

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These swaps represent agreements under which the buyer has purchased default protection on certain underlying corporate bonds held in its portfolio. These contracts allow Jackson to sell the protected bonds at par value to the counterparty if a default event occurs in exchange for periodic payments made by Jackson for the life of the agreement.

The estimated sensitivity of Jackson's profit and shareholders' equity to equity and interest rate risks provided below is net of the related changes in amortisation of DAC. The effect on the related changes in amortisation of DAC provided is based on the current 'grandfathered' US GAAP DAC basis but does not include any effect from an acceleration or deceleration of amortisation of DAC.

(i)

Sensitivity to equity risk

Jackson had variable annuity contracts with guarantees, for which the net amount at risk (NAR) is defined as the amount of guaranteed benefit in excess of current account value, as follows:

| 31 December 2018 | Minimum return | Account value | Net amount at risk | Weighted average attained age | Period until expected annuitisation |
|--|----------------|---------------|--------------------|-------------------------------|-------------------------------------|
| | % | £m | £m | Years | Years |
| Return of net deposits plus a minimum return | | | | | |
| GMDB | 0-6% | 98,653 | 4,437 | 66.5 years | |
| GMWB – premium only | 0% | 1,924 | 62 | | |
| GMWB* | 0-5%† | 197 | 20 | | |
| GMAB – premium only | 0% | 26 | – | | |
| Highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| GMDB | | 8,531 | 1,113 | 67.1 years | |
| GMWB – highest anniversary only | | 2,220 | 314 | | |
| GMWB* | | 535 | 89 | | |
| Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| GMDB | 0-6% | 5,454 | 1,217 | 69.5 years | |
| GMIB‡ | 0-6% | 1,256 | 648 | | 0.1 years |
| GMWB* | 0-8%† | 91,788 | 16,835 | | |
| 31 December 2017 | Minimum return | Account value | Net amount at risk | Weighted average attained age | Period until expected annuitisation |
| | % | £m | £m | Years | Years |
| Return of net deposits plus a minimum return | | | | | |
| GMDB | 0-6% | 100,451 | 1,665 | 66.0 years | |
| GMWB – premium only | 0% | 2,133 | 20 | | |

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| | | | | |
|--|-------|--------|-------|------------|
| GMWB* | 0-5%† | 235 | 13 | |
| GMAB – premium only | 0% | 38 | – | |
| Highest specified anniversary account value minus withdrawals post-anniversary | | | | |
| GMDB | | 9,099 | 96 | 66.5 years |
| GMWB – highest anniversary only | | 2,447 | 51 | |
| GMWB* | | 667 | 47 | |
| Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary | | | | |
| GMDB | 0-6% | 5,694 | 426 | 69.0 years |
| GMIB‡ | 0-6% | 1,484 | 436 | 0.4 years |
| GMWB* | 0-8%† | 93,227 | 4,393 | |

*

Amounts shown for GMWB comprise sums for the ‘not for life’ portion (where the guaranteed withdrawal base less the account value equals to the net amount at risk (NAR)), and a ‘for life’ portion (where the NAR has been estimated as the present value of future expected benefit payment remaining after the amount of the ‘not for life’ guaranteed benefits is zero).

†

Ranges shown based on simple interest. The upper limits of 5 per cent or 8 per cent simple interest are approximately equal to 4.1 per cent and 6 per cent respectively, on a compound interest basis over a typical 10-year bonus period. For example $1 + 10 \times 0.05$ is similar to 1.04 growing at a compound rate of 4 per cent for a further nine years.

‡

The GMIB guarantees are substantially reinsured.

Account balances of contracts with guarantees were invested in variable separate accounts as follows:

| Mutual fund type: | 31 Dec 2018 £m | 31 Dec 2017 £m |
|-------------------|----------------|----------------|
| Equity | 78,387 | 80,843 |
| Bond | 13,901 | 13,976 |
| Balanced | 19,903 | 19,852 |
| Money market | 824 | 681 |
| Total | 113,015 | 115,352 |

As noted above, Jackson is exposed to equity risk through the options embedded in the fixed index annuity liabilities and guarantees included in certain variable annuity benefits as illustrated above. This risk is managed using an equity hedging programme to minimise the risk of a significant economic impact as a result of increases or decreases in equity market levels. Jackson purchases futures and options that hedge the risks inherent in these products, while also considering the impact of rising and falling guaranteed benefit fees.

Due to the nature of valuation under IFRS of the free-standing derivatives and the variable annuity guarantee features, this hedge, while highly effective on an economic basis, would not automatically offset within the financial statements as the impact of equity market movements resets the free-standing derivatives immediately while the hedged liabilities reset more slowly and fees are recognised prospectively in the period in which they are earned.

In addition to the exposure explained above, Jackson is also exposed to equity risk from its holding of equity securities, partnerships in investment pools and other financial derivatives.

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The estimated sensitivity of Jackson's profit and shareholders' equity to immediate increases and decreases in equity markets is shown below. The sensitivities are shown net of related changes in DAC amortisation, as described above.

| | 31 Dec 2018 £m | | | | 31 Dec 2017 £m | | | |
|---|----------------|--------|----------|--------|----------------|--------|----------|--------|
| | Decrease | | Increase | | Decrease | | Increase | |
| | of 20% | of 10% | of 20% | of 10% | of 20% | of 10% | of 20% | of 10% |
| Pre-tax profit, net of related changes in amortisation of DAC | 1,058 | 427 | 58 | (125) | 1,107 | 336 | 619 | 262 |
| Related deferred tax effects | (222) | (90) | (12) | 26 | (233) | (71) | (130) | (55) |
| Net sensitivity of profit after tax and shareholders' equity* | 836 | 337 | 46 | (99) | 874 | 265 | 489 | 207 |

*

The table above has been prepared to exclude the impact of the instantaneous equity movements on the separate account fees. In addition, the sensitivity movements shown include those relating to the fixed index annuity and the reinsurance of GMIB guarantees.

The above table provides sensitivity movements at a point in time while the actual impact on financial results would vary contingent upon the volume of new product sales and lapses, changes to the derivative portfolio, correlation of market returns and various other factors including volatility, interest rates and elapsed time.

The directional movements in the sensitivities reflect the hedging programme in place at 31 December 2018 and 2017.

(ii)

Sensitivity to interest rate risk

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 fixed annuity liabilities of Jackson's 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. The GMWB features attached to variable annuity business (other than 'for life' components) are accounted for under US GAAP at fair-value and, therefore, will be sensitive to changes in interest rates.

Debt securities and related derivatives are marked to fair value. Value movements on derivatives, again net of related changes to amortisation of DAC and deferred tax, are recorded within the income statement. Fair value movements on debt securities, net of related changes to amortisation of DAC and deferred tax, are recorded within other comprehensive income. The estimated sensitivity of these items and policyholder liabilities to a 1 per cent and 2 per cent decrease and increase in interest rates is as follows:

| | 31 Dec 2018 £m | | | | 31 Dec 2017 £m | | | |
|--|----------------|---------|----------|---------|----------------|---------|----------|---------|
| | Decrease | | Increase | | Decrease | | Increase | |
| | of 2% | of 1% | of 1% | of 2% | of 2% | of 1% | of 1% | of 2% |
| Profit and loss: | | | | | | | | |
| Pre-tax profit effect (net of related changes in amortisation of DAC) | (3,535) | (1,718) | 1,201 | 2,210 | (4,079) | (1,911) | 1,373 | 2,533 |
| Related effect on charge for deferred tax | 742 | 361 | (252) | (464) | 857 | 401 | (288) | (532) |
| Net profit effect | (2,793) | (1,357) | 949 | 1,746 | (3,222) | (1,510) | 1,085 | 2,001 |
| Other comprehensive income: | | | | | | | | |
| Direct effect on carrying value of debt securities (net of related changes in amortisation of DAC) | 4,134 | 2,346 | (2,346) | (4,134) | 3,063 | 1,700 | (1,700) | (3,063) |
| Related effect on movement in deferred tax | (868) | (493) | 493 | 868 | (643) | (357) | 357 | 643 |

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| | | | | | | | | |
|--|-------|-------|---------|---------|-------|-------|---------|---------|
| Net effect | 3,266 | 1,853 | (1,853) | (3,266) | 2,420 | 1,343 | (1,343) | (2,420) |
| Total net effect on shareholders' equity | 473 | 496 | (904) | (1,520) | (802) | (167) | (258) | (419) |

These sensitivities are shown for interest rates in isolation only and do not include other movements in credit risk that may affect credit spreads and valuations of debt securities. Similar to the sensitivity to equity risk, the sensitivity movements provided in the table above are at a point in time and reflect the hedging programme in place on the balance sheet date, while the actual impact on financial results would vary contingent upon a number of factors.

(iii)

Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Group's US operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2018, the average and closing rates were US\$1.34 (31 December 2017: US\$1.29) and US\$1.27 (31 December 2017: US\$1.35) to £1.00 sterling respectively. A 10 per cent increase (weakening of the dollar) or decrease (strengthening of the dollar) in these rates would reduce or increase profit before tax attributable to shareholders, profit for the year and shareholders' equity attributable to US insurance operations respectively as follows:

| | A 10% increase in US\$:£ exchange rates | | A 10% decrease in US\$:£ exchange rates | |
|--|--|---------|--|---------|
| | 2018 £m | 2017 £m | 2018 £m | 2017 £m |
| Profit before tax attributable to shareholders | (159) | (54) | 194 | 66 |
| Profit for the year | (136) | (20) | 166 | 24 |
| Shareholders' equity attributable to US insurance operations | (508) | (456) | 620 | 557 |

(iv)

Other sensitivities

The total profit of Jackson is sensitive to market risk on the assets covering liabilities other than variable annuity business segregated in the separate accounts.

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest-sensitive life business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders. 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 actual experience of Jackson, industry benchmarking and future expectations. A detailed analysis of actual experience is measured by internally developed expense, mortality and persistency studies.

For variable annuity business, an assumption made is the expected long-term level of separate account returns, which for 2018 was 7.4 per cent (2017: 7.4 per cent). The impact of using this return is reflected in two principal ways, namely:

Through the projected expected gross profits that are used to determine the amortisation of deferred acquisition costs. This is applied through the use of a mean reversion technique; and

The required level of provision for claims for guaranteed minimum death, 'for life' withdrawal, and income benefits.

Jackson is sensitive to mortality risk, lapse risk and other types of policyholder behaviour, such as the utilisation of its GMWB product features. Jackson's persistency assumptions reflect a combination of recent experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. These assumptions vary by relevant factors, such as product, policy duration, attained age and for variable annuity

lapse assumptions, the extent to which guaranteed benefits are ‘in the money’ relative to policy account values. Changes in these assumptions, which are assessed on an annual basis after considering recent experience, could have a material impact on policyholder liabilities and therefore on profit before tax. See further information in note B1.2.

In addition, in the absence of hedging, equity and interest rate movements can both cause a loss directly or an increased future sensitivity to policyholder behaviour. Jackson has an extensive derivative programme that seeks to manage the exposure to such altered equity markets and interest rates.

C7.4

UK and Europe insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders’ equity to market and other risks

The IFRS basis results of the shareholder-backed business for the UK and Europe insurance operations are most sensitive to the following factors:

- Asset/liability matching;
 -
 - Default rate experience;
 -
 - Annuitant mortality; and
 -
- The difference between the rates of return on corporate bonds and risk-free rates.

Further details are described below.

The adjusted IFRS operating profit based on longer-term investment returns for UK and Europe insurance operations is sensitive to changes in longevity assumptions affecting the carrying value of liabilities to policyholders for UK shareholder-backed annuity business. At the total IFRS profit level, the result is particularly sensitive to temporary value movements on assets backing the capital of the shareholder-backed annuity business.

With-profits business

With-profits sub-fund business

The shareholder results of the UK with-profits business (including non-participating annuity business of the with-profits sub-fund) are only sensitive to market risk through the indirect effect of investment performance on declared policyholder bonuses.

The investment assets of UK with-profits funds are subject to market risk. Changes in their carrying value, net of related changes to asset-share liabilities of with-profits contracts, affect the level of unallocated surplus of the fund. Therefore, the level of unallocated surplus is particularly sensitive to the level of investment returns on the portion of the assets that represents surplus. However, as unallocated surplus is accounted for as a liability under IFRS, movements in its value do not affect shareholders’ profit and equity.

The shareholder results of the UK with-profits fund are currently one-ninth of the cost of bonuses declared to with-profits policyholders. For certain unitised with-profits products, such as the PruFund range of funds, the bonuses represent the policyholders’ net return based on the smoothed unit price of the selected investment fund. Investment performance is a key driver of bonuses declared, and hence the shareholder results. Due to the ‘smoothed’ basis of bonus declaration, the sensitivity to short-term investment performance is relatively low. However, longer-term investment performance and persistency trends may affect future shareholder transfers.

Shareholder-backed annuity business

Profits from shareholder-backed annuity business are most sensitive to:

-
- The extent to which the duration of the assets held closely matches the expected duration of the liabilities under the contracts;
-
- Actual versus expected default rates on assets held;
-
- The difference between the rates of return on corporate bonds and risk-free rates;
-
- The variance between actual and expected mortality experience;
-
- The extent to which changes to the assumed rate of improvements in mortality give rise to changes in the measurement of liabilities; and
-
- Changes in renewal expense levels.

In addition, the level of profit is affected by change in the level of reinsurance cover.

A decrease in assumed mortality rates of 1 per cent would decrease pre-tax profit by approximately £37 million (2017: £66 million). A decrease in credit default assumptions of five basis points would increase pre-tax profit by £99 million (2017: £198 million). A decrease in renewal expenses (excluding asset management expenses) of 5 per cent would increase pre-tax profit by £21 million (2017: £40 million). The effect on profit would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above. The net effect on profit after tax and shareholders' equity from all the changes in assumptions as described above would be an increase of approximately £69 million (2017: £143 million). See C4.1(d)(iii) for further details on mortality assumptions.

Unit-linked and other business

Unit-linked and other business represents a comparatively small proportion of the in-force business of the UK and Europe insurance operations.

Due to the matching of policyholder liabilities to attaching asset value movements, the UK unit-linked business is not directly affected by market or credit risk. The liabilities of other business are also broadly insensitive to market risk. Profits from unit-linked and similar contracts primarily arise from the excess of charges to policyholders for management of assets, over expenses incurred. The former is most sensitive to the net accretion of funds under management as a function of new business, persistency and timing of death. The accounting impact of the latter is dependent upon the amortisation of acquisition costs in line with the emergence of margins (for insurance contracts) and amortisation in line with service provision (for the investment management component of investment contracts). By virtue of the design features of most of the contracts that provide low levels of mortality cover, the profits are relatively insensitive to changes in mortality experience.

Sensitivity to interest rate risk and other market risk

By virtue of the fund structure, product features and basis of accounting, the policyholder liabilities of the UK and Europe insurance operations are, except annuity business, not generally exposed to interest rate risk. At 31 December 2018, annuity liabilities accounted for 95 per cent (31 December 2017: 98 per cent) of UK non-linked shareholder-backed business liabilities. For annuity business, liabilities are exposed to interest rate risk. However, the net exposure is substantially ameliorated by virtue of the close matching of assets with appropriate duration. The level of matching from period to period can vary depending on management actions and economic factors so it is possible for a degree of mis-matching profits or losses to arise.

The close matching by the Group of assets of appropriate duration to annuity liabilities is based on maintaining economic and regulatory capital. Liabilities are measured differently under Solvency II reporting requirements than under IFRS resulting in an alteration to the assets used to measure the IFRS annuity liabilities. As a result, IFRS has a different sensitivity to interest rate and credit risk than under Solvency II.

The estimated sensitivity of the UK non-linked shareholder-backed business (principally annuities business) to a movement in interest rates is as follows:

| | 31 Dec 2018 £m | | | | 31 Dec 2017 £m | | | |
|--|------------------|------------------|-------------------|-------------------|------------------|------------------|-------------------|-------------------|
| | A decrease of 2% | A decrease of 1% | An increase of 1% | An increase of 2% | A decrease of 2% | A decrease of 1% | An increase of 1% | An increase of 2% |
| Carrying value of debt securities and derivatives | 7,369 | 3,317 | (2,792) | (5,193) | 13,497 | 5,805 | (4,659) | (8,541) |
| Policyholder liabilities | (4,784) | (2,162) | 1,801 | 3,317 | (9,426) | (4,210) | 3,443 | 6,295 |
| Related deferred tax effects | (446) | (199) | 171 | 323 | (658) | (254) | 190 | 348 |
| Net sensitivity of profit after tax and shareholders' equity | 2,139 | 956 | (820) | (1,553) | 3,413 | 1,341 | (1,026) | (1,898) |

In addition, the shareholder-backed portfolio of UK non-linked insurance operations (covering policyholder liabilities and shareholders' equity) includes equity securities and investment properties. Excluding any offsetting effects on the measurement of policyholder liabilities, a fall in their value would have given rise to the following effects on pre-tax profit, profit after tax and shareholders' equity.

| | 2018 £m | | 2017 £m | |
|--|-------------------|-------------------|-------------------|-------------------|
| | A decrease of 20% | A decrease of 10% | A decrease of 20% | A decrease of 10% |
| Pre-tax profit | (336) | (168) | (332) | (166) |
| Related deferred tax effects | 57 | 29 | 57 | 28 |
| Net sensitivity of profit after tax and shareholders' equity | (279) | (139) | (275) | (138) |

A 10 or 20 per cent increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The market risk sensitivities shown above reflect the impact of temporary market movements and, therefore, the primary effect of such movements would, in the Group's segmental analysis of profits, be included within the short-term fluctuations in investment returns.

C7.5

Asset management and other operations

(i)

Asset management

(a)

Sensitivities to foreign exchange risk

Consistent with the Group's accounting policies, the profits of Eastspring Investments and US asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. The rates for the functional currencies of most significant operations are shown in note A1.

A 10 per cent increase in the relevant exchange rates (strengthening of the pound sterling) would have reduced reported profit before tax attributable to shareholders, and shareholders' equity excluding goodwill attributable to Eastspring Investments and US asset management operations, by £10 million and £43 million respectively (2017: £30 million and £53 million, respectively).

(b)

Sensitivities to other financial risks for asset management operations

The profits of asset management businesses are sensitive to the level of assets under management, as this significantly affects the value of management fees earned by the business in the current and future periods. The Group's asset management operations do not hold significant investments in property or equities.

(ii)

Other operations

The Group holds certain derivatives that are used to manage foreign currency movements and macroeconomic exposures. The fair value of these derivatives is sensitive to the combined effect of movements in exchange rates, interest rates and inflation rates. The possible permutations cover a wide range of scenarios. For indicative purposes, a reasonably possible range of fair value movements based on historical experience could be plus or minus £150 million.

Other operations are sensitive to credit risk on the loan portfolio of the Prudential Capital operation. Total debt securities held at 31 December 2018 by Prudential Capital were £1,884 million (2017: £2,238 million). Debt securities held by Prudential Capital are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholders' equity.

C8

Tax assets and liabilities

Deferred tax

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

| | 2018 £m | | | | |
|---|----------|---------------------------------|---|--|--------------|
| | At 1 Jan | Movement in income statement | Movement through other comprehensive income and equity | Other movements including foreign currency movements | At 31 Dec |
| Deferred tax assets | | | | | |
| Unrealised losses or gains on investments | 14 | 1 | 93 | 5 | 113 |
| Balances relating to investment and insurance contracts | 1 | – | – | – | 1 |
| Short-term temporary differences | 2,532 | (266) | (8) | 81 | 2,339 |
| Capital allowances | 14 | – | – | 1 | 15 |
| Unused tax losses | 66 | 23 | – | 38 | 127 |
| Total | 2,627 | (242) | 85 | 125 | 2,595 |
| Deferred tax liabilities | | | | | |
| Unrealised losses or gains on investments | (1,748) | 666 | 195 | 20 | (867) |
| Balances relating to investment and insurance contracts | (872) | (91) | – | (39) | (1,002) |

| | | | | | |
|----------------------------------|---------|-----|------|-------|---------|
| Short-term temporary differences | (2,041) | 68 | (15) | (109) | (2,097) |
| Capital allowances | (54) | (1) | – | (1) | (56) |
| Total | (4,715) | 642 | 180 | (129) | (4,022) |

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

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

C9

Defined benefit pension schemes

(i)

Background and summary economic and IAS 19 financial positions

The Group’s businesses operate a number of pension schemes. The specific features of these schemes vary in accordance with the regulations of the country in which the employees are located, although they are, in general, funded by the Group and based either on a cash balance formula or on years of service and salary earned in the last year or years of employment. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). PSPS accounts for 82 per cent (2017: 82 per cent) of the underlying scheme liabilities of the Group’s defined benefit schemes.

The Group also operates two smaller UK defined benefit schemes in respect of Scottish Amicable (SASPS) and M&G (M&GGPS). In addition, there are two small defined benefit schemes in Taiwan which have negligible deficits.

Under IAS 19, ‘Employee Benefits’ and IFRIC 14 ‘IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction’, the Group is only able to recognise a surplus to the extent that it is able to access the surplus either through an unconditional right of refund or through reduced future contributions relating to ongoing service of active members. The Group has no unconditional right of refund to any surplus in PSPS. Accordingly, the PSPS surplus recognised is restricted to the present value of the economic benefit to the Group from the difference between the estimated future ongoing contributions and the full future cost of service for the active members. In contrast, the Group is able to access the surplus of SASPS and M&GGPS. Therefore, the amounts recognised for these schemes are the IAS 19 valuation amount (either a surplus or deficit).

The Group asset/liability in respect of defined benefit pension schemes is as follows:

| | 31 Dec 2018 £m | | | | | 31 Dec 2017 £m | | | | |
|---|----------------|----------|--------|---------------|-------|----------------|----------|--------|---------------|-------|
| | PSPS | SASPS | M&GGPS | Other schemes | Total | PSPS | SASPS | M&GGPS | Other schemes | Total |
| | note (a) | note (b) | | | | note (a) | note (b) | | | |
| Underlying economic surplus (deficit) | 908 | (79) | 131 | (1) | 959 | 721 | (137) | 109 | (1) | 692 |
| Less: unrecognised surplus | (677) | – | – | – | (677) | (485) | – | – | – | (485) |
| Economic surplus (deficit) (including investment in Prudential insurance) | 231 | (79) | 131 | (1) | 282 | 236 | (137) | 109 | (1) | 207 |

| | | | | | | | | | | |
|---|-----|------|-------|-----|-------|-----|-------|-------|-----|-------|
| policies)note (c) | | | | | | | | | | |
| Attributable to: | | | | | | | | | | |
| UK with-profits fund | 162 | (32) | – | – | 130 | 165 | (55) | – | – | 110 |
| Shareholder-backed business | 69 | (47) | 131 | (1) | 152 | 71 | (82) | 109 | (1) | 97 |
| Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies | – | – | (225) | – | (225) | – | – | (151) | – | (151) |
| IAS 19 pension asset (liability) on the Group statement of financial positionnote (d) | 231 | (79) | (94) | (1) | 57 | 236 | (137) | (42) | (1) | 56 |

Notes

(a)

No deficit or other funding is required for PSPS. Deficit funding, where applicable, is apportioned in the ratio of 70/30 between the UK with-profits fund and shareholder-backed business following detailed considerations in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity.

(b)

The deficit of SASPS has been allocated 40 per cent to the UK with-profits fund and 60 per cent to the shareholders' fund as at 31 December 2018 and 2017.

(c)

The underlying position on an economic basis reflects the assets (including investments in Prudential insurance policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes.

(d)

At 31 December 2018, the PSPS pension asset of £231 million (31 December 2017: £236 million) and the other schemes' pension liabilities of £174 million (31 December 2017: £180 million) are included within 'Other debtors' and 'Provisions' respectively on the consolidated statement of financial position.

Triennial actuarial valuations

Defined benefit pension schemes in the UK are generally required to be subject to full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. The actuarial valuation differs from the IAS 19 accounting basis valuation in a number of respects, including the discount rate assumption where IAS 19 prescribes a rate based on high-quality corporate bonds while a more 'prudent' assumption is used for the actuarial valuation.

The information on the latest completed actuarial valuation for the UK schemes is shown in the table below:

| | | | |
|--|---------------------------------|--|-------------------------------------|
| | PSPS | SASPS | M&GGPS |
| Last completed actuarial valuation date | 5 April 2017 | 31 March 2017 | 31 December 2014* |
| Valuation actuary, all Fellows of the Institute and Faculty of Actuaries | C G SingerTowers Watson Limited | Jonathan SeedXafinity Consulting Limited | Paul Belok AON Hewitt Limited |

| | | | |
|--|---|---|---|
| Funding level at the last valuation | 105 per cent | 75 per cent | 99 per cent |
| Deficit funding arrangement agreed with the Trustees based on the last completed valuation | No deficit or other funding required. Ongoing contributions for active members are at the minimum level required under the scheme rules (approximately £5 million per annum excluding expenses) | Deficit funding of £26 million per annum from 1 April 2017 until 31 March 2027, or earlier if the scheme's funding level reaches 100 per cent before this date. The deficit funding will be reviewed every three years at subsequent valuations | No deficit funding required from 1 January 2016 |

*The triennial valuation for M&GGPS as at 31 December 2017 is currently in progress.

(ii)

Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the years shown were as follows:

| | 31 Dec 2018 % | 31 Dec 2017 % |
|--|---------------|---------------|
| Discount rate* | 2.8 | 2.5 |
| Rate of increase in salaries | 3.3 | 3.1 |
| Rate of inflation† | | |
| Retail prices index (RPI) | 3.3 | 3.1 |
| Consumer prices index (CPI) | 2.3 | 2.1 |
| Rate of increase of pensions in payment for inflation: | | |
| PSPS: | | |
| Guaranteed (maximum 5%) | 2.5 | 2.5 |
| Guaranteed (maximum 2.5%) | 2.5 | 2.5 |
| Discretionary | 2.5 | 2.5 |
| Other schemes | 3.3 | 3.1 |

*

The discount rate has been determined by reference to an 'AA' corporate bond index, adjusted where applicable to allow for the difference in duration between the index and the pension liabilities.

†

The rate of inflation reflects the long-term assumption for UK RPI or CPI depending on the tranche of the schemes.

The calculations are based on current mortality estimates with an allowance made for expected future improvements in mortality. This allowance reflected the CMI 2015 Core projections model (2017: CMI 2014 projections model, with scheme-specific calibrations). In 2018, for members post retirement long-term mortality improvement rates of 1.75 per cent per annum (2017: 1.75 per cent per annum) and 1.50 per cent per annum (2017: 1.25 per cent per annum) were applied for males and females, respectively.

(iii)

Estimated pension scheme surpluses and deficits

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. The

IAS 19 basis excludes the investments in Prudential policies. At 31 December 2018, M&GGPS held investments in Prudential insurance policies of £225 million (31 December 2017: £151 million).

Movements on the pension scheme surplus determined on the economic basis are as follows, with the effect of the application of IFRIC 14 being shown separately:

| | 2018 £m | | Actuarial gains and losses in other comprehensive income | | Surplus (deficit) in schemes at 31 Dec 2018 |
|---|--|-------------------------------------|--|------|---|
| | Surplus (deficit) in schemes at 1 Jan 2018 | (Charge) credit to income statement | Contributions paid | | |
| All schemes | | | | | |
| Underlying position (without the effect of IFRIC 14) | | | | | |
| Surplus (deficit) | 692 | (88) | 303 | 52 | 959 |
| Less: amount attributable to UK with-profits fund | (473) | 38 | (178) | (20) | (633) |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | 219 | (50) | 125 | 32 | 326 |
| Related tax | (42) | 10 | (24) | (6) | (62) |
| Net of shareholders' tax | 177 | (40) | 101 | 26 | 264 |
| Application of IFRIC 14 for the derecognition of PSPS surplus | | | | | |
| Derecognition of surplus | (485) | (13) | (179) | – | (677) |
| Less: amount attributable to UK with-profits fund | 363 | 8 | 132 | – | 503 |
| Shareholders' share: | | | | | |
| Gross of tax | (122) | (5) | (47) | – | (174) |
| Related tax | 23 | 1 | 9 | – | 33 |
| Net of shareholders' tax | (99) | (4) | (38) | – | (141) |
| With the effect of IFRIC 14 | | | | | |
| Surplus (deficit) | 207 | (101) | 124 | 52 | 282 |
| Less: amount attributable to UK with-profits fund | (110) | 46 | (46) | (20) | (130) |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | 97 | (55) | 78 | 32 | 152 |
| Related tax | (19) | 11 | (15) | (6) | (29) |
| Net of shareholders' tax | 78 | (44) | 63 | 26 | 123 |

Underlying investments of the schemes

On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the plans' assets comprise the following investments:

| | 31 Dec 2018 | | | | 31 Dec 2017 | | | |
|----------|-------------|------------------------|-------------|---|-------------|------------------------|-------------|---|
| | PSPS £m | Other schemes £m | Total £m | % | PSPS £m | Other schemes £m | Total £m | % |
| Equities | | | | | | | | |
| UK | 8 | 6 | 14 | – | 9 | 67 | 76 | 1 |

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| | | | | | | | | |
|-------------------------|-------|-------|-------|-----|-------|-------|-------|-----|
| Overseas | 204 | 53 | 257 | 3 | 226 | 272 | 498 | 6 |
| Bonds | | | | | | | | |
| Government | 4,596 | 538 | 5,134 | 61 | 5,040 | 655 | 5,695 | 63 |
| Corporate | 1,586 | 454 | 2,040 | 24 | 1,491 | 248 | 1,739 | 20 |
| Asset-backed securities | 263 | 12 | 275 | 3 | 164 | – | 164 | 2 |
| Derivatives | 103 | 4 | 107 | 1 | 188 | (6) | 182 | 2 |
| Properties | 143 | 143 | 286 | 3 | 140 | 130 | 270 | 3 |
| Other assets | 172 | 198 | 370 | 5 | 216 | 77 | 293 | 3 |
| Total value of assets | 7,075 | 1,408 | 8,483 | 100 | 7,474 | 1,443 | 8,917 | 100 |

(iv)

Sensitivity of the pension scheme liabilities to key variables

The sensitivity information below is based on the core scheme liabilities and assumptions at the balance sheet date. The sensitivities are calculated based on a change in one assumption with all other assumptions being held constant. As such, interdependencies between the assumptions are excluded. The impact of the rate of inflation assumption sensitivity includes the impact of inflation on the rate of increase in salaries and rate of increase of pensions in payment.

The sensitivities of the underlying pension scheme liabilities as shown below do not directly equate to the 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 the financial position of PSPS and SASPS to the UK with-profits fund as described above.

| | Assumption applied | | Sensitivity change in assumption | Impact of sensitivity on scheme liabilities on IAS 19 basis | | |
|-------------------|--------------------|------|---|---|------|------|
| | 2018 | 2017 | | 2018 | 2017 | |
| Discount rate | 2.8% | 2.5% | Decrease by 0.2% | Increase in scheme liabilities by: | | |
| | | | | PSPS | 3.5% | 3.5% |
| | | | | Other schemes | 5.0% | 5.4% |
| Discount rate | 2.8% | 2.5% | Increase by 0.2% | Decrease in scheme liabilities by: | | |
| | | | | PSPS | 3.3% | 3.4% |
| | | | | Other schemes | 4.7% | 4.9% |
| Rate of inflation | 3.3% | 3.1% | RPI: Decrease by 0.2% | Decrease in scheme liabilities by: | | |
| | | | | PSPS | 0.6% | 0.6% |
| | | | | Other schemes | 3.9% | 3.9% |
| Rate of inflation | 2.3% | 2.1% | CPI: Decrease by 0.2% with consequent reduction in salary increases | Decrease in scheme liabilities by: | | |
| | | | | PSPS | 0.6% | 0.6% |
| | | | | Other schemes | 3.9% | 3.9% |
| Mortality rate | | | Increase life expectancy by 1 year | Increase in scheme liabilities by: | | |
| | | | | PSPS | 3.9% | 4.0% |
| | | | | Other schemes | 3.9% | 3.8% |

C10

Share capital, share premium and own shares

| Issued shares of 5p each fully paid | 2018 | | | 2017 | | |
|--|------------------------------|------------------------|------------------------|------------------------------|------------------------|------------------------|
| | Number of ordinary shares | Share capital £m | Share premium £m | Number of ordinary shares | Share capital £m | Share premium £m |
| At 1 January | 2,587,175,445 | 129 | 1,948 | 2,581,061,573 | 129 | 1,927 |
| Shares issued under share-based schemes | 5,868,964 | 1 | 16 | 6,113,872 | – | 21 |
| At 31 December | 2,593,044,409 | 130 | 1,964 | 2,587,175,445 | 129 | 1,948 |

Amounts recorded in share capital represent the nominal value of the shares issued. The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued is credited to the share premium account.

At 31 December 2018, there were options outstanding under save as you earn schemes to subscribe for shares as follows:

| | Number of shares to subscribe for | Share price range | | Exercisable by year |
|-------------|-----------------------------------|----------------------|--------|---------------------|
| | | from | to | |
| 31 Dec 2018 | 4,885,804 | 901p | 1,455p | 2024 |
| 31 Dec 2017 | 6,448,853 | 629p | 1,455p | 2023 |

Transactions by Prudential plc and its subsidiaries in Prudential plc shares

The Group buys and sells Prudential plc shares ('own shares') either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £170 million as at 31 December 2018 (31 December 2017: £250 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 31 December 2018, 9.6 million (31 December 2017: 11.4 million) Prudential plc shares with a market value of £135 million (31 December 2017: £218 million) were held in such trusts all of which are for employee incentive plans. The maximum number of shares held during 2018 was 14.9 million which was in March 2018.

The Company purchased the following number of shares in respect of employee incentive plans. The shares purchased each month are as follows:

| | Number of shares | 2018 share price | | | Number of shares | 2017 share price | | |
|----------|---------------------|---------------------|-----------|------------|---------------------|---------------------|-----------|------------|
| | | Low £ | High £ | Cost £ | | Low £ | High £ | Cost £ |
| January | 51,555 | 19.18 | 19.40 | 996,536 | 62,388 | 15.83 | 16.02 | 989,583 |
| February | 55,765 | 17.91 | 18.10 | 1,004,362 | 65,706 | 15.70 | 16.09 | 1,052,657 |
| March | 55,623 | 18.25 | 18.54 | 1,025,238 | 70,139 | 16.40 | 16.54 | 1,159,950 |
| April | 1,664,334 | 16.67 | 17.95 | 29,113,556 | 3,090,167 | 16.58 | 16.80 | 51,369,760 |
| May | 63,334 | 18.91 | 19.38 | 1,216,136 | 55,744 | 17.50 | 17.62 | 979,645 |
| June | 181,995 | 18.21 | 18.65 | 3,335,725 | 182,780 | 17.52 | 18.00 | 3,269,447 |
| July | 55,888 | 17.68 | 17.86 | 993,779 | 51,984 | 17.72 | 17.93 | 927,452 |
| August | 60,384 | 18.04 | 18.10 | 1,090,283 | 55,857 | 18.30 | 18.73 | 1,025,802 |

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| | | | | | | | | |
|-----------|-----------|-------|-------|------------|-----------|-------|-------|------------|
| September | 82,612 | 16.95 | 16.98 | 1,400,868 | 51,226 | 17.45 | 17.97 | 912,151 |
| October | 148,209 | 15.62 | 16.84 | 2,477,127 | 136,563 | 17.99 | 18.22 | 2,483,879 |
| November | 67,162 | 15.95 | 15.96 | 1,071,633 | 53,951 | 18.38 | 18.40 | 992,123 |
| December | 73,744 | 13.99 | 14.30 | 1,045,278 | 53,519 | 18.26 | 18.47 | 986,000 |
| Total | 2,560,605 | | | 44,770,521 | 3,930,024 | | | 66,148,449 |

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 31 December 2018 was 3.0 million (31 December 2017: 6.4 million) and the cost of acquiring these shares of £20 million (2017: £71 million) is included in the cost of own shares. The market value of these shares as at 31 December 2018 was £42 million (31 December 2017: £121 million). During 2018, these funds made net disposals of 3,368,506 Prudential shares (2017: acquisitions of 372,029) for a net decrease of £50.5 million to book cost (2017: net increase of £9.4 million).

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during 2018 or 2017.

D

Other notes

D1

Corporate transactions

D1.1

Gains/(losses) on disposal of businesses and corporate transactions

‘(Loss) gain on disposal of businesses and corporate transactions’ comprises the following:

| | 2018 £m | 2017 £m |
|--|---------|---------|
| Loss arising on reinsurance of part of UK shareholder-backed annuity portfolio | (508) | – |
| Other transactions | (80) | 223 |
| | (588) | 223 |

Notes

(i)

Loss arising on reinsurance of part of UK shareholder-backed annuity portfolio

In March 2018, M&G Prudential announced the reinsurance of £12.0 billion (as at 31 December 2017) of its shareholder-backed annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured the liabilities to Rothesay Life, which is expected to be followed by a court sanctioned legal transfer, under Part VII of the Financial Services and Markets Act 2000 (Part VII), of most of the portfolio to Rothesay Life by 30 June 2019.

The reinsurance agreement became effective on 14 March 2018. A reinsurance premium of £12,149 million has been recognised within 'Outward reinsurance premiums' in the income statement and settled via the transfer of financial investments and other assets to Rothesay Life. After allowing for the recognition of a reinsurance asset and associated changes to policyholder liabilities, a loss of £(508) million was recognised in 2018 in relation to the transaction.

The reinsured annuity business that will be transferred once the Part VII process is complete has been classified as held for sale in these consolidated financial statements in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations'.

The assets and liabilities of the M&GPrudential annuity business classified as held for sale on the statement of financial position are as follows:

| | 31 Dec 2018 £m |
|---|----------------|
| Assets | |
| Reinsurer's share of insurance contract liabilities | 10,502 |
| Other assets (including cash and cash equivalents) | 66 |
| Assets held for sale | 10,568 |
| Liabilities | |
| Policyholder liabilities | 10,502 |
| Other liabilities | 66 |
| Liabilities held for sale | 10,568 |

(ii)
Other transactions

Other transaction costs of £80 million incurred by the Group in 2018 primarily relate to additional costs incurred in exiting from the NPH broker-dealer business and costs related to preparation for the previously announced intention to demerge M&GPrudential from Prudential plc, resulting in two separately listed entities.

In 2017, the Group completed its disposal of its Korea life business, realising a gain of £61 million principally as a result of recycling from other comprehensive income cumulative exchange gains of this business. On 15 August 2017, the Group, through its subsidiary National Planning Holdings, Inc. (NPH) sold its US independent broker-dealer network to LPL Financial LLC which realised a gain of £162 million in 2017. Together these two transactions generated a gain on disposal of businesses and corporate transactions of £223 million.

D1.2 Acquisition of TMB Asset Management Co., Ltd. in Thailand

In September 2018, the Group completed its initial acquisition of 65 per cent of TMB Asset Management Co., Ltd. (TMBAM), an asset management company in Thailand, from TMB Bank Public Limited (TMB) for £197 million.

The terms of the sale agreement include a call option exercisable (by the Group) after three years and a put option exercisable (by TMB) after four years which, if exercised, triggers the purchase of the remaining 35 per cent of the business. The put option, in line with IFRS, has been recognised as a financial liability and a reduction in shareholders' equity of £106 million as of the acquisition date, being the discounted expected consideration payable for the remaining 35 per cent (£109 million as of 31 December 2018).

The fair value of the acquired assets, assumed liabilities and resulting goodwill are shown in the table below:

| | 31 Dec 2018 £m |
|---|----------------|
| Assets | |
| Intangible assets | 5 |
| Other assets | 26 |
| Cash and cash equivalents | 2 |
| Total assets | 33 |
| Other liabilities | (10) |
| Non-controlling interests | (7) |
| Net assets acquired and liabilities assumed | 16 |
| Goodwill arising on acquisition* | 181 |
| Purchase consideration | 197 |

*

The goodwill on acquisition of £181 million (retranslated to £186 million at 31 December 2018) is mainly attributable to the expected benefits from new customers and synergies. Refer to note C5.1 for changes to the carrying amount of goodwill during the year.

The acquisition of TMBAM contributed £18 million to revenue and £5 million to adjusted IFRS operating profit based on longer-term investment returns and profit before tax of the Group for the post-acquisition period from 27 September to 31 December 2018. There is no material impact on the Group's revenue and profit for 2018 if the acquisition had occurred on 1 January 2018.

D2

Contingencies and related obligations

Litigation and regulatory matters

In addition to the matters set out in note B3(iii) in relation to the Financial Conduct Authority review of past annuity sales, the Group is involved in various litigation and regulatory issues. These may from time to time include class actions involving Jackson. While the outcome of such litigation and regulatory issues cannot be predicted with certainty, the Company believes that their ultimate outcome will not have a material adverse effect on the Group's financial condition, results of operations, or cash flows.

D3

Post balance sheet events

Dividends

The second interim ordinary dividend for the year ended 31 December 2018, that was approved by the Board of Directors after 31 December 2018, is described in note B6.

Renewal of strategic bancassurance alliance with United Overseas Bank Limited

In January 2019, the Group announced the renewal of its regional strategic bancassurance alliance with United Overseas Bank Limited (UOB). The new agreement extends the original alliance, which commenced in 2010 to 2034 and increases the geographical scope to include a fifth market, Vietnam, alongside the existing markets across

Singapore, Malaysia, Thailand and Indonesia.

As part of this transaction, Prudential has agreed to pay UOB an initial fee of £662 million (translated using a Singapore dollar: £ foreign exchange rate of 1.7360) for distribution rights which is not dependent on future sales volumes. This amount will be paid in three instalments of £230 million in February 2019, £331 million in January 2020 and £101 million in January 2021. In line with the Group's policy, these amounts will be capitalised as a distribution rights intangible asset.

Additional Unaudited Financial Information

I IFRS profit and loss

I(a) Analysis of long-term insurance business adjusted IFRS operating profit based on longer-term investment returns by driver

This schedule classifies the Group's adjusted IFRS operating profit based on longer-term investment returns from long-term insurance operations into the underlying drivers, using the following categories:

–
Spread income represents the difference between net investment income and amounts credited to certain policyholder accounts. It excludes the operating investment return on shareholder net assets, which has been separately disclosed as expected return on shareholder assets.

–
Fee income represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.

–
With-profits represent the pre-tax shareholders' transfer from the with-profits funds for the year.

–
Insurance margin primarily represents profits derived from the insurance risks of mortality and morbidity.

–
Margin on revenues primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.

–
Acquisition costs and administration expenses represent expenses incurred in the year attributable to shareholders. These exclude items such as restructuring costs which are not included in the segment profit for insurance, as well as items that are more appropriately included in other sources of earnings lines (eg investment expenses are netted against investment income as part of spread income or fee income as appropriate).

–
DAC adjustments comprise DAC amortisation for the year, excluding amounts related to short-term fluctuations in investment returns, net of costs deferred in respect of new business.

Analysis of adjusted IFRS operating profit based on longer-term investment returns by source and margin analysis of Group long-term insurance business

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The following analysis expresses certain of the Group's sources of adjusted IFRS operating profit based on long-term investment returns as a margin of policyholder liabilities or other relevant drivers. Details on the calculation of the Group's average policyholder liability balances are given in note (iv) at the end of this section.

| | 2018 | | | | Average liability £m note (iv) | Margin bps note (ii) |
|--|------------|----------|------------------------|-------------|--------------------------------------|----------------------------|
| | Asia £m | US £m | UK and Europe £m | Total £m | | |
| Spread income | 232 | 583 | 84 | 899 | 85,850 | 105 |
| Fee income | 210 | 2,445 | 56 | 2,711 | 175,443 | 155 |
| With-profits | 71 | – | 320 | 391 | 147,318 | 27 |
| Insurance margin | 1,481 | 949 | 50 | 2,480 | | |
| Margin on revenues | 2,105 | – | 149 | 2,254 | | |
| Expenses: | | | | | | |
| Acquisition costsnote (i) | (1,503) | (759) | (57) | (2,319) | 6,802 | (34)% |
| Administration expenses | (1,029) | (1,204) | (180) | (2,413) | 265,597 | (91) |
| DAC adjustmentsnote (v) | 326 | (114) | 4 | 216 | | |
| Expected return on shareholder assets | 129 | 11 | 102 | 242 | | |
| | 2,022 | 1,911 | 528 | 4,461 | | |
| Share of related tax charges from joint ventures and associatenote (vi) | (40) | | – | (40) | | |
| Longevity reinsurance and other management actions to improve solvency | | | 58 | 58 | | |
| Changes in longevity assumption basis | | | 441 | 441 | | |
| Provision for guaranteed minimum pension equalisation | | | (55) | (55) | | |
| Insurance recoveries of costs associated with review of past annuity sales | | | 166 | 166 | | |
| Long-term business adjusted IFRS operating profit based on longer-term investment returns | 1,982 | 1,911 | 1,138 | 5,031 | | |

| | 2017 AER | | | | Average liability £m note (iv) | Margin bps note(ii) |
|--------------------|------------|----------|------------------------|-------------|--------------------------------------|---------------------------|
| | Asia £m | US £m | UK and Europe £m | Total £m | | |
| Spread income | 234 | 751 | 137 | 1,122 | 88,908 | 126 |
| Fee income | 205 | 2,343 | 61 | 2,609 | 166,839 | 156 |
| With-profits | 59 | – | 288 | 347 | 136,474 | 25 |
| Insurance margin | 1,341 | 906 | 55 | 2,302 | | |
| Margin on revenues | 2,098 | – | 189 | 2,287 | | |
| Expenses: | | | | | | |

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| | | | | | | |
|---|---------|---------|-------|---------|---------|-------|
| Acquisition costsnote (i) | (1,499) | (876) | (68) | (2,443) | 6,958 | (35)% |
| Administration expenses | (967) | (1,174) | (164) | (2,305) | 261,114 | (88) |
| DAC adjustmentsnote (v) | 241 | 260 | 4 | 505 | | |
| Expected return on shareholder assets | 126 | 4 | 104 | 234 | | |
| | 1,838 | 2,214 | 606 | 4,658 | | |
| Share of related tax charges from joint ventures and associatenote (vi) | (39) | – | – | (39) | | |
| Longevity reinsurance and other management actions to improve solvency | – | – | 276 | 276 | | |
| Changes in longevity assumption basis | – | – | 204 | 204 | | |
| Provision for review of past annuity sales | – | – | (225) | (225) | | |
| Long-term business adjusted IFRS operating profit based on longer-term investment returns | 1,799 | 2,214 | 861 | 4,874 | | |

2017 CERnote (iii)

| | Asia | US | UK and Europe | Total | Average liability | Margin |
|---|---------|---------|---------------|---------|-------------------|-----------|
| | £m | £m | £m | £m | £m | bps |
| | | | | | note (iv) | note (ii) |
| Spread income | 228 | 725 | 137 | 1,090 | 87,553 | 124 |
| Fee income | 195 | 2,262 | 61 | 2,518 | 162,267 | 155 |
| With-profits | 57 | – | 288 | 345 | 136,496 | 25 |
| Insurance margin | 1,293 | 875 | 55 | 2,223 | | |
| Margin on revenues | 2,021 | – | 189 | 2,210 | | |
| Expenses: | | | | | | |
| Acquisition costsnote (i) | (1,450) | (846) | (68) | (2,364) | 6,767 | (35)% |
| Administration expenses | (933) | (1,134) | (164) | (2,231) | 255,313 | (87) |
| DAC adjustmentsnote (v) | 235 | 251 | 4 | 490 | | |
| Expected return on shareholder assets | 120 | 4 | 104 | 228 | | |
| | 1,766 | 2,137 | 606 | 4,509 | | |
| Share of related tax charges from joint ventures and associatenote (vi) | (39) | – | – | (39) | | |
| Longevity reinsurance and other management actions to improve solvency | – | – | 276 | 276 | | |
| Changes in longevity assumption basis | – | – | 204 | 204 | | |
| Provision for review of past annuity sales | – | – | (225) | (225) | | |
| Long-term business adjusted IFRS operating profit based on | 1,727 | 2,137 | 861 | 4,725 | | |

longer-term investment
returns

Notes to sources of earnings tables throughout I(a)

(i)
The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business.

(ii)
Margin represents the operating return earned in the year as a proportion of the relevant class of average policyholder liabilities excluding unallocated surplus.

(iii)
The 2017 comparative information has been presented at AER and CER to eliminate the impact of foreign exchange translation. CER results are calculated by translating prior year results using the current year foreign exchange rates. All CER profit figures have been translated at current year average rates. For Asia CER average policyholder liability calculations, the amounts have been translated using current year opening and closing exchange rates. For the US CER average liability calculations, the amounts have been translated at the current year month-end closing exchange rates. See note A1 in the IFRS financial statements for foreign exchange rates used.

(iv)
For UK and Europe and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the year, as a proxy for average balances throughout the year. The calculation of average liabilities for Jackson is generally derived from month-end balances throughout the year, as opposed to opening and closing balances only. The average liabilities for fee income in Jackson have been calculated using daily balances instead of month-end balances in order to provide a more meaningful analysis of the fee income, which is charged on the daily account balance. Average liabilities for spread income are based on the general account liabilities to which spread income attaches. Average liabilities used to calculate the administration expense margin exclude the REALIC liabilities reinsured to third parties prior to the acquisition by Jackson.

(v)
The DAC adjustments contain a credit of £55 million in respect of joint ventures and associate in 2018 (2017: AER credit of £43 million).

(vi)
Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In 2018, the Group altered the presentation of its analysis of Asia adjusted IFRS operating profit based on longer-term investment returns by driver to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the margin analysis on a consistent basis as the rest of the Asia operations. 2017 comparatives have been re-presented accordingly.

Margin analysis of long-term insurance business – Asia

| | 2018 | | | 2017 AER | | | 2017 CER | | | note (iii) |
|--------------------|------------------|----------------------------|---------------|--------------|----------------------------|---------------|--------------|----------------------------|---------------|------------|
| | Profit £m | Average liability £m | Margin bps | Profit £m | Average liability £m | Margin bps | Profit £m | Average liability £m | Margin bps | |
| Spread income | 232 | 18,895 | 123 | 234 | 16,359 | 143 | 228 | 16,351 | 139 | |
| Fee income | 210 | 20,105 | 104 | 205 | 18,767 | 109 | 195 | 18,638 | 105 | |
| With-profits | 71 | 36,309 | 20 | 59 | 30,115 | 20 | 57 | 30,137 | 19 | |
| Insurance margin | 1,481 | | | 1,341 | | | 1,293 | | | |
| Margin on revenues | 2,105 | | | 2,098 | | | 2,021 | | | |
| Expenses: | | | | | | | | | | |
| Acquisition costs | note (i) (1,503) | 3,744 | (40)% | (1,499) | 3,805 | (39)% | (1,450) | 3,671 | (39)% | |

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| | | | | | | | | | |
|---|---------|--------|-------|-------|--------|-------|-------|--------|-------|
| Administration expenses | (1,029) | 39,000 | (264) | (967) | 35,126 | (275) | (933) | 34,989 | (267) |
| DAC adjustmentsnote (v) | 326 | | | 241 | | | 235 | | |
| Expected return on shareholder assets | 129 | | | 126 | | | 120 | | |
| | 2,022 | | | 1,838 | | | 1,766 | | |
| Share of related tax charges from joint ventures and associatenote (vi) | (40) | | | (39) | | | (39) | | |
| Adjusted IFRS operating profit based on longer-term investment returns | 1,982 | | | 1,799 | | | 1,727 | | |

Analysis of Asia adjusted IFRS operating profit based on longer-term investment returns by driver:

–
Spread income has increased on a CER basis by 2 per cent (AER: decreased by 1 per cent) to £232 million in 2018, with a decrease in the margin on a CER basis from 139 basis points in 2017 to 123 basis points in 2018 (AER: decreased from 143 basis points in 2017 to 123 basis points in 2018) predominantly reflecting the change in investment mix, country and product mix.

–
Fee income has increased by 8 per cent on a CER basis (AER: 2 per cent) to £210 million in 2018, broadly in line with the increase in movement in average unit-linked policyholder liabilities.

–
Insurance margin has increased by 15 per cent on a CER basis (AER: 10 per cent) to £1,481 million in 2018, primarily reflecting the continued growth of the in-force book, which contains a relatively high proportion of risk-based products.

–
Margin on revenues has increased by 4 per cent on a CER basis (AER: less than one per cent) to £2,105 million in 2018, primarily reflecting higher premiums together with the effect of changes in product mix and higher premium allocation to policyholders.

–
Acquisition costs have increased by 4 per cent on a CER basis (AER: less than one per cent) to £1,503 million in 2018, compared to a 2 per cent increase in APE sales on a CER basis, resulting in an increase in the acquisition costs ratio. The analysis in the table above uses shareholder acquisition costs as a proportion of total APE sales. If with-profits sales were excluded from the denominator, the acquisition cost ratio would become 69 per cent (2017: 67 per cent on a CER basis), the increase being the result of product and country mix.

–
Administration expenses including renewal commissions have increased by 10 per cent on a CER basis (AER: 6 per cent) to £1,029 million in 2018 as the business continues to expand. On a CER basis, the administration expense ratio has decreased from 267 basis points in 2017 to 264 basis points in 2018 as a result of changes in country and product mix.

Margin analysis of long-term insurance business – US

| | 2018 | | | 2017 AER | | | 2017 CERnote (iii) | | |
|---------------|--------------|---|----------------------------|--------------|---|----------------------------|--------------------|---|----------------------------|
| | Profit £m | Average liability £m note (iv) | Margin bps note (ii) | Profit £m | Average liability £m note (iv) | Margin bps note (ii) | Profit £m | Average liability £m note (iv) | Margin bps note (ii) |
| Spread income | 583 | 37,608 | 155 | 751 | 38,918 | 193 | 725 | 37,571 | 193 |
| Fee income | 2,445 | 133,407 | 183 | 2,343 | 125,440 | 187 | 2,262 | 120,997 | 187 |

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| | | | | | | | | | |
|--|---------|---------|-------|---------|---------|-------|---------|---------|-------|
| Insurance margin | 949 | | | 906 | | | 875 | | |
| Expenses | | | | | | | | | |
| Acquisition costsnote (i) | (759) | 1,542 | (49)% | (876) | 1,662 | (53)% | (846) | 1,605 | (53)% |
| Administration expenses | (1,204) | 175,319 | (69) | (1,174) | 169,725 | (69) | (1,134) | 164,061 | (69) |
| DAC adjustments | (114) | | | 260 | | | 251 | | |
| Expected return on shareholder assets | 11 | | | 4 | | | 4 | | |
| Adjusted IFRS operating profit based on longer-term investment returns | 1,911 | | | 2,214 | | | 2,137 | | |

Analysis of US adjusted IFRS operating profit based on long-term investment returns by driver:

Spread income has decreased by 20 per cent on a CER basis (AER: 22 per cent) to £583 million in 2018. The reported spread margin decreased to 155 basis points from 193 basis points in 2017, primarily due to the impact of increasing LIBOR on interest rate swaps, lower investment yields and maturing of swaps previously entered into to more closely match the asset and liability duration. Excluding the effect of these historic swap transactions, the spread margin would have been 130 basis points (2017: 144 basis points at CER and AER).

Fee income has increased by 8 per cent on a CER basis (AER: 4 per cent) to £2,445 million during 2018, primarily due to higher average separate account balances resulting from positive net flows from variable annuity business and market appreciation during most of 2018 before a decline in the fourth quarter of 2018. Fee income margin has decreased to 183 basis points (2017:187 basis points at CER and AER) primarily reflecting a change in business mix.

Insurance margin represents profits from insurance risks, including variable annuity guarantees and other sundry items. Insurance margin increased by 8 per cent on a CER basis (AER: 5 per cent) to £949 million in 2018 mainly due to higher income from variable annuity guarantees and favourable mortality experience.

Acquisition costs, which are commissions and expenses incurred to acquire new business, including those that are not deferrable, have decreased by 10 per cent on a CER basis (AER: 13 per cent). This reflects a 4 per cent decrease in APE sales and lower level of front-ended commissions.

Administration expenses increased by 6 per cent on a CER basis (AER: 3 per cent) to £(1,204) million during 2018, primarily as a result of higher asset-based commissions. Excluding these asset-based commissions, the resulting administration expense ratio would be lower at 34 basis points (2017: 35 basis points at CER and AER).

DAC adjustments in 2018 was negative £(114) million (compared to £251 million credit in 2017 on a CER basis) due to an increase in the DAC amortisation charge. The higher DAC amortisation charge arises largely from an acceleration of amortisation of £(194) million (2017: credit for deceleration of £83 million on a CER basis) primarily relating to the market returns in 2018 and the reversal of the benefit received in 2015 under the mean reversion formula.

Analysis of adjusted IFRS operating profit based on longer-term investment returns before and after acquisition costs and DAC adjustments

| 2018 £m | | | | 2017 AER £m | | | | 2017 CER |
|----------------------------------|-------------------|----------|---------------------------------|----------------------------------|-------------------|----------|---------------------------------|----------------------------------|
| Before acquisition costs and DAC | Acquisition costs | | | Before acquisition costs and DAC | Acquisition costs | | | Before acquisition costs and DAC |
| | Incurred | Deferred | After acquisition costs and DAC | | Incurred | Deferred | After acquisition costs and DAC | |
| | | | | | | | | |

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| | adjustments | | adjustments | | adjustments | | adjustments | | adjustments |
|---|-------------|-------|-------------|-------|-------------|-------|-------------|-------|-------------|
| Total adjusted IFRS operating profit based on longer-term investment returns before acquisition costs and DAC adjustments | 2,784 | | | 2,784 | 2,830 | | | 2,830 | 2,732 |
| Less new business strain | | (759) | 569 | (190) | | (876) | 663 | (213) | |
| Amortisation of previously deferred acquisition costs: | | | | | | | | | |
| Normal | | | (489) | (489) | | | (489) | (489) | |
| (Accelerated)decelerated | | | (194) | (194) | | | 86 | 86 | |
| Total | 2,784 | (759) | (114) | 1,911 | 2,830 | (876) | 260 | 2,214 | 2,732 |

Analysis of adjusted IFRS operating profit based on longer-term investment returns for US operations by product

| | 2018 £m | 2017 £m | | 2018 vs 2017 % | |
|---------------------------------------|---------|---------|-------|----------------|-------|
| | | AER | CER | AER | CER |
| Spread business | 297 | 317 | 306 | (6)% | (3)% |
| Fee business | 1,532 | 1,788 | 1,726 | (14)% | (11)% |
| Life and other business | 82 | 109 | 105 | (25)% | (22)% |
| Total insurance operationsnote | 1,911 | 2,214 | 2,137 | (14)% | (11)% |
| US asset management and broker-dealer | 8 | 10 | 9 | (20)% | (11)% |
| Total US operations | 1,919 | 2,224 | 2,146 | (14)% | (11)% |

Note

The analysis of adjusted IFRS operating profit based on longer-term investment returns for US operations by product represents the net profit generated by each line of business after allocation of costs. Broadly:

– Spread business is the net profit for fixed annuity, fixed indexed annuity and guaranteed investment contracts and largely comprises spread income less costs.

– Fee business represents profits from variable annuity products. As well as fee income, revenue for this product line includes spread income from investments directed to the general account and other variable annuity fees included in insurance margin.

– Life and other business includes the profits from the REALIC business and other closed life books. Revenue allocated to this product line includes spread income and premiums and policy charges for life protection, which are included in insurance margin after claim costs. Insurance margin forms the vast majority of revenue.

Margin analysis of long-term insurance business – UK and Europe

| | | 2018 | | | 2017 | |
|--|---------------|-----------|-----------|--------|-----------|-----------|
| | Profit | Average | Margin | Profit | Average | Margin |
| | £m | liability | bps | £m | liability | bps |
| | | note (iv) | note (ii) | | note (iv) | note (ii) |
| Spread income | 84 | 29,347 | 29 | 137 | 33,631 | 41 |
| Fee income | 56 | 21,931 | 26 | 61 | 22,632 | 27 |
| With-profits | 320 | 111,009 | 29 | 288 | 106,359 | 27 |
| Insurance margin | 50 | | | 55 | | |
| Margin on revenues | 149 | | | 189 | | |
| Expenses: | | | | | | |
| Acquisition costs | note (i) (57) | 1,516 | (4)% | (68) | 1,491 | (5)% |
| Administration expenses | (180) | 51,278 | (35) | (164) | 56,263 | (29) |
| DAC adjustments | 4 | | | 4 | | |
| Expected return on shareholder assets | 102 | | | 104 | | |
| | 528 | | | 606 | | |
| Longevity reinsurance and other management actions to improve solvency | 58 | | | 276 | | |
| Changes in longevity assumption basis | 441 | | | 204 | | |
| Provision for guaranteed minimum pension equalisation | (55) | | | - | | |
| Insurance recoveries of costs associated with review of past annuity sales | 166 | | | - | | |
| Provision for review of past annuity sales | - | | | (225) | | |
| Adjusted IFRS operating profit based on longer-term investment returns | 1,138 | | | 861 | | |

Analysis of UK and Europe adjusted IFRS operating profit based on longer-term investment returns by driver:

–

Spread income has reduced from £137 million in 2017 to £84 million in 2018 reflecting the run-off of the in-force annuity portfolio and the effect of the reinsurance of £12.0 billion of annuity portfolios to Rothesay Life entered into in March 2018.

–

Fee income principally represents asset management fees from unit-linked business (including direct investment only business to Group pension schemes where liability flows are driven by a small number of large single mandate transactions and mostly arises within the UK and Europe asset management business). Fee income is after costs relating to managing the underlying funds which include recent rationalisation activity to remove sub-scale funds. If these costs and the direct investment only schemes are excluded, the fee margin on the remaining balances would be 36 basis points (2017: 40 basis points).

–

Margin on revenues represents premium charges for expenses of shareholder-backed business and other sundry net income.

–
The £441 million favourable effect of longevity assumption relates to changes to annuitant mortality assumptions to reflect current mortality experience and the adoption of the Continuous Mortality Investigation (CMI) 2016 model. Further information on changes to mortality assumptions is given in note C4.1(d) in the IFRS financial statements.

–
An allowance provision of £(55) million has been made in 2018 to reflect the costs of equalising guaranteed minimum pension benefits on pension products sold by the insurance business following the ruling by the High Court in October 2018. Further information is provided in note C9 in the IFRS financial statements.

–
The 2018 insurance recoveries of costs associated with undertaking a review of past annuity sales of £166 million (2017: nil) is explained in note B4(b) in the IFRS financial statements.

I(b)

Asia operations – analysis of IFRS operating profit by business unit

Operating profit based on longer-term investment returns for Asia operations is analysed as follows:

| | 2018 £m | AER 2017 £m | CER 2017 £m | 2017 AER vs 2018 | 2017 CER vs 2018 |
|---|---------|----------------|----------------|---------------------|------------------------|
| Hong Kong | 443 | 346 | 332 | 28% | 33% |
| Indonesia | 416 | 457 | 415 | (9)% | 0% |
| Malaysia | 194 | 173 | 178 | 12% | 9% |
| Philippines | 43 | 41 | 38 | 5% | 13% |
| Singapore | 329 | 272 | 269 | 21% | 22% |
| Thailand | 113 | 107 | 108 | 6% | 5% |
| Vietnam | 149 | 135 | 129 | 10% | 16% |
| South-east Asia operations including Hong Kong | 1,687 | 1,531 | 1,469 | 10% | 15% |
| China | 143 | 121 | 119 | 18% | 20% |
| Taiwan | 51 | 43 | 41 | 19% | 24% |
| Other | 51 | 71 | 67 | (28)% | (24)% |
| Non-recurrent items ^{note} | 94 | 75 | 73 | 25% | 29% |
| Total insurance operations | 2,026 | 1,841 | 1,769 | 10% | 15% |
| Share of related tax charges from joint ventures and associate* | (40) | (39) | (39) | (3)% | (3)% |
| Development expenses | (4) | (3) | (3) | (33)% | (33)% |
| Total long-term business operating profit | 1,982 | 1,799 | 1,727 | 10% | 15% |
| Asset management (Eastspring Investments) | 182 | 176 | 171 | 3% | 6% |
| Total Asia operations | 2,164 | 1,975 | 1,898 | 10% | 14% |

*

Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In 2018, the Group altered the presentation of its analysis of Asia operating profit to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the operating profit analysis on a consistent basis as the rest of the Asia's operations. 2017 comparatives have been re-presented accordingly.

Note

In 2018, the IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £94 million (2017: £75 million) representing a small number of items that are not expected to reoccur, including the impact of a refinement to the run-off of the allowance for prudence within technical provisions, within

Singapore.

I(c)

Analysis of asset management operating profit based on longer-term investment returns

| | 2018 £m | |
|--|--|--|
| | M&GPrudential asset management note (ii) | Eastspring Investments note (ii) |
| Operating income before performance-related fees | 1,100 | 424 |
| Performance-related fees | 15 | 17 |
| Operating income (net of commission)note (i) | 1,115 | 441 |
| Operating expensenote (i) | (654) | (232) |
| Share of associate's results | 16 | – |
| Group's share of tax on joint ventures' operating profit | – | (27) |
| Operating profit based on longer-term investment returns | 477 | 182 |
| Average funds under management | £276.6bn | £146.3bn |
| Margin based on operating income* | 40bps | 29bps |
| Cost/income ratio† | 59% | 55% |

| | 2017 £m | |
|--|--|--|
| | M&GPrudential asset management note (ii) | Eastspring Investments note (ii) |
| Operating income before performance-related fees | 1,034 | 421 |
| Performance-related fees | 53 | 17 |
| Operating income (net of commission)note (i) | 1,087 | 438 |
| Operating expensenote (i) | (602) | (238) |
| Share of associate's results | 15 | – |
| Group's share of tax on joint ventures' operating profit | – | (24) |
| Operating profit based on longer-term investment returns | 500 | 176 |
| Average funds under management | £275.9bn | £128.4bn |
| Margin based on operating income* | 37bps | 33bps |
| Cost/income ratio† | 58% | 56% |

*

Margin represents operating income before performance-related fees as a proportion of the related funds under management (FUM). Monthly closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group's insurance operations that are managed by third parties outside the Prudential Group are excluded from these amounts. M&GPrudential operating expense includes £27 million of Brexit preparation costs.

†

Cost/income ratio represents cost as a percentage of operating income before performance-related fees.

Notes

(i)

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Operating income and expense include the Group's pre-tax share of contribution from joint ventures but excludes any contribution from associate. In the consolidated income statement of the IFRS financial statements, the net post-tax income of the joint ventures and associate is shown as a single line item.

(ii)

Operating income before performance related fees and margin on related funds under management for M&GPrudential asset management and Eastspring Investments can be further analysed as follows:

| M&GPrudential asset management | | | | | | |
|--|--------|--------|----------------|--------|-------|--------|
| Operating income before performance related fees | | | | | | |
| | Retail | Margin | Institutional* | Margin | Total | Margin |
| | £m | bps | £m | bps | £m | bps |
| 2018 | 662 | 85 | 438 | 22 | 1,100 | 40 |
| 2017 | 604 | 85 | 430 | 21 | 1,034 | 37 |

| Eastspring Investments | | | | | | |
|--|--------|--------|----------------|--------|-------|--------|
| Operating income before performance related fees | | | | | | |
| | Retail | Margin | Institutional* | Margin | Total | Margin |
| | £m | bps | £m | bps | £m | bps |
| 2018 | 252 | 50 | 172 | 18 | 424 | 29 |
| 2017 | 249 | 57 | 172 | 20 | 421 | 33 |

*

Institutional includes internal funds.

I(d)

Contribution to UK long-term financial metrics from specific management actions undertaken to position the balance sheet more efficiently under the Solvency II regime

In 2018, further management actions were taken to improve the solvency of the UK and Europe insurance operations and to mitigate market risks. These actions included repositioning the fixed income asset portfolio to improve the trade-off between yield and credit risk. No new longevity reinsurance transactions were undertaken in 2018 (2017: longevity reinsurance transactions entered into covering £0.5 billion of IFRS annuity liabilities).

The effect of these actions on the UK's long-term IFRS operating profit, underlying free surplus generation and EEV operating profit, before restructuring costs, is shown in the tables below.

| IFRS operating profit of UK long-term business before tax | | |
|---|---------|---------|
| | 2018 £m | 2017 £m |
| Shareholder-backed annuity new business | 9 | 9 |
| In-force business: | | |
| Longevity reinsurance transactions | – | 31 |
| Other management actions to improve solvency | 58 | 245 |
| Changes in longevity assumption basis | 441 | 204 |
| Provision for the review of past annuity sales | – | (225) |
| Insurance recoveries in respect of above costs | 166 | – |
| Provision for guaranteed minimum pension equalisation | (55) | – |
| | 610 | 255 |

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| | | |
|--|-------|-----|
| With-profits and other in-force | 519 | 597 |
| Total IFRS operating profit before restructuring costs | 1,138 | 861 |

Underlying free surplus generation of UK long-term business

| | 2018 £m | 2017 £m |
|--|---------|---------|
| Expected in-force and return on net worth | 686 | 706 |
| Longevity reinsurance transactions | – | 15 |
| Other management actions to improve solvency | 54 | 385 |
| Changes in longevity assumption basis | 364 | 179 |
| Provision for the review of past annuity sales | – | (187) |
| Insurance recoveries in respect of above costs | 138 | – |
| Provision for guaranteed minimum pension equalisation | (95) | – |
| | 461 | 392 |
| Other in-force | 130 | (28) |
| Underlying free surplus generated from in-force business | 1,277 | 1,070 |
| New business strain | (102) | (175) |
| Total free surplus generation before restructuring costs | 1,175 | 895 |

EEV post-tax operating profit of UK long-term business

| | 2018 £m | 2017 £m |
|---|---------|---------|
| Unwind of discount and other expected return | 474 | 465 |
| Longevity reinsurance transactions | – | (6) |
| Other management actions to improve solvency | 141 | 127 |
| Changes in longevity assumption basis | 330 | 195 |
| Provision for the review of past annuity sales | – | (187) |
| Insurance recoveries in respect of above costs | 138 | – |
| Provision for guaranteed minimum pension equalisation | (48) | – |
| | 561 | 129 |
| Other in-force | (13) | 79 |
| Operating profit from in-force business | 1,022 | 673 |
| New business profit | 352 | 342 |
| Total EEV operating profit before restructuring costs | 1,374 | 1,015 |

II

Other information

II(a)

Holding company cash flow*

| | 2018 £m | 2017 £m |
|--------------------------------------|---------|---------|
| Net cash remitted by business units: | | |
| Asia | 699 | 645 |
| US | 342 | 475 |
| UK and Europe: | | |
| With-profits remittance | 233 | 215 |
| | 97 | 105 |

| | | |
|---|---------|---------|
| Shareholder-backed insurance business remittance | | |
| Asset management remittance | 324 | 323 |
| | 654 | 643 |
| Other UK paid to the Group (including Prudential Capital) | 37 | 25 |
| Total UK net remittances to the Group | 691 | 668 |
| Net remittances to the Group from business unitsnote (i) | 1,732 | 1,788 |
| Net interest paid | (366) | (415) |
| Tax received | 142 | 152 |
| Corporate activities | (206) | (207) |
| Total central outflows | (430) | (470) |
| Operating holding company cash flow before dividend | 1,302 | 1,318 |
| Dividend paid | (1,244) | (1,159) |
| Operating holding company cash flow after dividend | 58 | 159 |
| Non-operating net cash flownote (ii) | 913 | (511) |
| Total holding company cash flow | 971 | (352) |
| Cash and short-term investments at beginning of year | 2,264 | 2,626 |
| Foreign exchange movements | 1 | (10) |
| Cash and short-term investments at end of yearnote (iii) | 3,236 | 2,264 |

*

The holding company cash flow differs from the IFRS cash flow statement, which includes all cash flows in the period including those relating to both policyholder and shareholder funds. The holding company cash flow is therefore a more meaningful indication of the Group's central liquidity.

Notes

(i)
Net cash remittances comprise dividends and other transfers from business units that are reflective of emerging earnings and capital generation.

(ii)
Non-operating net cash flow principally relates to the issue of subordinated debt less repayment of debt, and payments for distribution rights and acquisition of subsidiaries.

(iii)

Including central finance subsidiaries.

II(b)

Funds under management

(a)

Summary

For our asset management businesses, funds managed on behalf of third parties are not recorded on the balance sheet. They are, however, a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing on those which are external to the Group and those primarily held by the insurance businesses. The table below analyses, by segment, the funds of the Group held in the statement of financial position and the external funds that are managed by Prudential's asset management operations.

| | 31 Dec 2018 £bn | 31 Dec 2017 £bn |
|-------------------------|-----------------|-----------------|
| Asia operations: | | |
| Internal funds | 89.5 | 81.4 |
| Eastspring | | |
| Investments' | 61.1 | 55.9 |
| external funds | | |
| | 150.6 | 137.3 |
| US operations: internal | | |
| funds | 183.1 | 178.3 |
| UK and Europe | | |
| operations: | | |
| Internal funds, | | |
| including | | |
| PruFund-backed | 174.3 | 186.8 |
| products | | |
| External funds | 146.9 | 163.9 |
| | 321.2 | 350.7 |
| Other operations | 2.4 | 3.0 |
| Group total funds | | |
| under management | 657.3 | 669.3 |
| note | | |

Note

Total funds under management comprise:

| | 31 Dec 2018 £bn | 31 Dec 2017 £bn |
|------------------|-----------------|-----------------|
| Total | | |
| investments per | | |
| the consolidated | | |
| statement of | 449.6 | 451.4 |
| financial | | |
| position | | |
| External funds | 208.0 | 219.8 |
| of | | |
| M&G Prudential | | |

| | | |
|---|-------|-------|
| and Eastspring Investments (as analysed in note (b) below) | | |
| Internally managed funds held in joint ventures and other adjustments | (0.3) | (1.9) |
| Group total funds under management | 657.3 | 669.3 |

(b)
Investment products – external funds under management

| | 2018 £m | | | | | 2017 £m | | | | |
|---------------------------------|---------------|----------------------|-------------|----------------------------|----------------|---------------|----------------------|-------------|----------------------------|----------------|
| | At 1 Jan 2018 | Market gross inflows | Redemptions | Market and other movements | At 31 Dec 2018 | At 1 Jan 2017 | Market gross inflows | Redemptions | Market and other movements | At 31 Dec 2017 |
| M&G Prudential Wholesale/Direct | 79,697 | 24,584 | (29,452) | (5,364) | 69,465 | 64,209 | 30,949 | (19,906) | 4,445 | 79,697 |
| M&G Prudential Institutional | 84,158 | 12,954 | (18,001) | (1,630) | 77,481 | 72,554 | 15,220 | (8,926) | 5,310 | 84,158 |
| Total | 163,855 | 37,538 | (47,453) | (6,994) | 146,946 | 136,763 | 46,169 | (28,832) | 9,755 | 163,855 |
| (i) Eastspring Investments | 55,885 | 212,070 | (212,156) | 5,258 | 61,057 | 45,756 | 215,907 | (211,271) | 5,493 | 55,885 |
| Total | 219,740 | 249,608 | (259,609) | (1,736) | 208,003 | 182,519 | 262,076 | (240,103) | 15,248 | 219,740 |

Notes

(i) The results exclude contribution from PruFund products: net inflows of £8.5 billion in 2018 (2017: £9.0 billion); funds under management of £43 billion as at 31 December 2018 (31 December 2017: £35.9 billion).

(ii) Market and other movements during the year for Eastspring investments include inflow of £9.3 billion funds under management from acquisition of TMB Asset Management Co., Ltd. ('TMBAM') in Thailand. See note D1.2 of the consolidated financial statements for further details.

(iii) The £208 billion (31 December 2017: £219.7 billion) investment products comprise £196.4 billion (31 December 2017: £210.4 billion) plus Asia Money Market Funds of £11.6 billion (31 December 2017: £9.3 billion).

(c) M&G and Eastspring Investments – total funds under management
M&G, the asset management business of M&G Prudential and Eastspring Investments, the Group's asset management business in Asia, manage funds from external parties and also funds for the Group's insurance operations. The table below analyses the total funds under management managed by M&G and Eastspring Investments respectively.

M&G

Eastspring Investments

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| | 31 Dec 2018 £bn | 31 Dec 2017 £bn | 31 Dec 2018 £bn note | 31 Dec 2017 £bn note |
|---------------------------------|-----------------|-----------------|-------------------------|-------------------------|
| External funds under management | 146.9 | 163.9 | 61.1 | 55.9 |
| Internal funds under management | 118.2 | 134.6 | 90.2 | 83.0 |
| Total funds under management | 265.1 | 298.5 | 151.3 | 138.9 |

Note

The external funds under management for Eastspring Investments include Asia Money Market Funds at 31 December 2018 of £11.6 billion (31 December 2017: £9.3 billion).

II(c)

Solvency II capital position

The estimated Group shareholder Solvency II surplus at 31 December 2018 was £17.2 billion, before allowing for payment of the 2018 second interim ordinary dividend and reflecting approved regulatory transitional measures as at 31 December 2018.

| Estimated Group shareholder Solvency II capital position* | 31 Dec 2018 | 31 Dec 2017 |
|---|-------------|-------------|
| Own Funds (£bn) | 30.2 | 26.4 |
| Solvency Capital Requirement (£bn) | 13.0 | 13.1 |
| Surplus (£bn) | 17.2 | 13.3 |
| Solvency ratio (%) | 232% | 202% |

*

The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

In accordance with Solvency II requirements, these results allow for:

–

Capital in Jackson in excess of 250 per cent of the US local Risk Based Capital requirement. As agreed with the Prudential Regulation Authority, this is incorporated in the result above as follows:

–

Own funds: represents Jackson's local US Risk Based available capital less 100 per cent of the US Risk Based Capital requirement (Company Action Level);

–

Solvency Capital Requirement: represents 150 per cent of Jackson's local US Risk Based Capital requirement (Company Action Level); and

–

No diversification benefits are taken into account between Jackson and the rest of the Group.

–

Matching adjustment for UK annuities and volatility adjustment for US dollar denominated Hong Kong with-profits business, based on approvals from the Prudential Regulation Authority and calibrations published by the European Insurance and Occupational Pensions Authority; and

–

UK transitional measures, which have been recalculated using management's estimate of the impact of operating and market conditions at the valuation date. An application to recalculate the transitional measures as at 31 December 2018 has been approved by the Prudential Regulation Authority and this recalculation will therefore be reflected in the formal regulatory Quantitative Reporting Templates as at 31 December 2018.

The Group shareholder Solvency II capital position excludes:

- A portion of Solvency II surplus capital (£1.7 billion at 31 December 2018) relating to the Group's Asian life operations, primarily due to the Solvency II definition of 'contract boundaries' which prevents some expected future cash flows from being recognised;
- The contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds in surplus (representing £5.5 billion of surplus capital from UK with-profits funds at 31 December 2018) and from the shareholders' share of the estate of with-profits funds; and
- The contribution to Own Funds and the Solvency Capital Requirement from pension funds in surplus.

It also excludes unrealised gains on certain derivative instruments taken out to protect Jackson against declines in long-term interest rates. At Jackson's request, the Department of Insurance Financial Services renewed its approval to carry these instruments at book value in the local statutory returns for the period 31 December 2018 to 1 October 2019. At 31 December 2018, applying this approval had the effect of decreasing local available statutory capital and surplus (and by extension Solvency II Own Funds and Solvency II surplus) by £0.1 billion, net of tax. This arrangement reflects an elective long-standing practice first put in place in 2009, which can be unwound at Jackson's discretion.

The 31 December 2018 Solvency II results above allow for the reinsurance of £12.0 billion of the UK annuity portfolio to Rothesay Life effective from 14 March 2018 and the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited. In total these items have resulted in a decrease to UK Solvency II surplus in 2018 of £3.3 billion with Group Solvency II surplus increasing by £0.4 billion.

Analysis of movement in Group capital position

A summary of the estimated movement in Group Solvency II surplus from £13.3 billion at year end 2017 to £17.2 billion at year end 2018 is set out in the table below. The movement from the Group Solvency II surplus at 31 December 2016 to the Solvency II surplus at 31 December 2017 is included for comparison.

| Analysis of movement in Group shareholder surplus | 2018 Surplus £bn | 2017 Surplus £bn |
|---|------------------|------------------|
| Estimated Solvency II surplus at beginning of year | 13.3 | 12.5 |
| Underlying operating experience | 4.1 | 3.2 |
| Management actions | 0.1 | 0.4 |
| Operating experience | 4.2 | 3.6 |
| Non-operating experience (including market movements) | (1.2) | (0.6) |
| M&GPrudential transactions | 0.4 | – |
| Other capital movements: | | |
| Net subordinated debt issuance/redemption | 1.2 | (0.2) |
| Foreign currency translation impacts | 0.5 | (0.7) |
| Dividends paid | (1.2) | (1.2) |
| Model changes | 0.0 | (0.1) |

Estimated Solvency II surplus at end of year 17.2 13.3

The estimated movement in Group Solvency II surplus over 2018 is driven by:

— Operating experience of £4.2 billion: generated by in-force business and new business written in 2018, after allowing for amortisation of the UK transitional measures and the impact of one-off management optimisations implemented over the year. This includes a £0.4 billion benefit from the impact of updates to UK longevity best estimate assumptions and a £0.1 billion benefit from an insurance recovery relating to the costs and any related redress of reviewing internally vesting annuities sold without advice after 1 July 2008;

— Non-operating experience of £(1.2) billion: resulting mainly from the negative impact of market movements, after allowing for the recalculation of the UK transitional measures at the valuation date, the impact of US Risk Based Capital updates announced in June 2018 to reflect US tax reform changes and the £(0.3) billion impact from the acquisition of TMB Asset Management Co., Ltd. (see IFRS Financial Statements note D1.2 for further information);

— M&GPrudential transactions of £0.4 billion: the beneficial impact on the Group Solvency II surplus of the UK annuities reinsurance transaction effective from 14 March 2018 and the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited after allowing for the impact of recalculation of the UK transitional measures as a result of these transactions;

— Other capital movements: comprising an increase in surplus from the net impact of debt raised offset by debt redeemed during 2018, a benefit from foreign currency translation and a reduction in surplus from payment of dividends; and

— Model changes: reflecting internal model changes approved by the Prudential Regulation Authority and other minor internal model calibration changes made in 2018.

Analysis of Group Solvency Capital Requirements

The split of the Group's estimated Solvency Capital Requirement by risk type including the capital requirements in respect of Jackson's risk exposures based on 150 per cent of US Risk Based Capital requirements (Company Action Level) but with no diversification between Jackson and the rest of the Group, is as follows:

| | 31 Dec 2018 | | 31 Dec 2017 | |
|--|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | % of undiversified | % of diversified | % of undiversified | % of diversified |
| Split of the Group's estimated Solvency Capital Requirements | Solvency Capital Requirements | Solvency Capital Requirements | Solvency Capital Requirements | Solvency Capital Requirements |
| Market | 57% | 70% | 57% | 71% |
| Equity | 13% | 23% | 14% | 23% |
| Credit | 23% | 38% | 24% | 38% |
| Yields (interest rates) | 16% | 6% | 13% | 7% |
| Other | 5% | 3% | 6% | 3% |
| Insurance | 24% | 20% | 26% | 21% |
| Mortality/morbidity | 5% | 2% | 5% | 2% |
| Lapse | 15% | 17% | 14% | 17% |
| Longevity | 4% | 1% | 7% | 2% |
| Operational/expense | 12% | 8% | 11% | 7% |
| FX translation | 7% | 2% | 6% | 1% |

Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds

| Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds | 31 Dec 2018 £bn | 31 Dec 2017 £bn |
|---|-----------------|-----------------|
| IFRS shareholders' equity | 17.2 | 16.1 |
| Restate US insurance entities from IFRS to local US statutory basis | (2.5) | (3.0) |
| Remove DAC, goodwill and intangibles | (4.6) | (4.0) |
| Add subordinated debt | 7.2 | 5.8 |
| Impact of risk margin (net of transitional measures) | (3.8) | (3.9) |
| Add value of shareholder transfers | 5.3 | 5.3 |
| Liability valuation differences | 13.3 | 12.1 |
| Increase in net deferred tax liabilities resulting from liability valuation differences above | (1.5) | (1.6) |
| Other | (0.4) | (0.4) |
| Estimated Solvency II Shareholder Own Funds | 30.2 | 26.4 |

The key items of the reconciliation as at 31 December 2018 are:

-
- £(2.5) billion represents the adjustment required to the Group's shareholders' funds in order to convert Jackson's contribution from an IFRS basis to the local statutory valuation basis. This item also reflects a de-recognition of Own Funds of £1.0 billion, equivalent to the value of 100 per cent of Risk Based Capital requirements (Company Action Level), as agreed with the Prudential Regulation Authority;
-
- £(4.6) billion due to the removal of DAC, goodwill and intangibles from the IFRS balance sheet;
-
- £7.2 billion due to the addition of subordinated debt which is treated as available capital under Solvency II but as a liability under IFRS;
-
- £(3.8) billion due to the inclusion of a risk margin for UK and Asia non-hedgeable risks, net of £1.6 billion from transitional measures (after allowing for recalculation of the transitional measures as at 31 December 2018) which are not applicable under IFRS;
-
- £5.3 billion due to the inclusion of the value of future shareholder transfers from with-profits business (excluding the shareholders' share of the with-profits estate, for which no credit is given under Solvency II), which is excluded from the determination of the Group's IFRS shareholders' funds;
-
- £13.3 billion mainly due to differences in insurance valuation requirements between Solvency II and IFRS, with Solvency II Own Funds partially capturing the value of in-force business which is excluded from IFRS;
-
- £(1.5) billion due to the impact on the valuation of net deferred tax liabilities resulting from the liability valuation differences noted above; and
-
- £(0.4) billion due to other items, including the impact of revaluing loans, borrowings and debt from IFRS to Solvency II.

Sensitivity analysis

The estimated sensitivity of the Group shareholder Solvency II capital position to significant changes in market conditions is as follows:

31 Dec 2018

31 Dec 2017

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| Impact of market sensitivities | Surplus £bn | Ratio | Surplus £bn | Ratio |
|--|-------------|-------|-------------|-------|
| Base position | 17.2 | 232% | 13.3 | 202% |
| Impact of: | | | | |
| 20% instantaneous fall in equity markets | (1.6) | (10)% | 0.7 | 9% |
| 40% fall in equity markets ¹ | (4.0) | (28)% | (2.1) | (11)% |
| 50 basis points reduction in interest rates ^{2,3} | (1.8) | (21)% | (1.0) | (14)% |
| 100 basis points increase in interest rates ³ | 1.2 | 20% | 1.2 | 21% |
| 100 basis points increase in credit spreads ⁴ | (1.7) | (9)% | (1.4) | (6)% |

Notes

1

Where hedges are dynamic, rebalancing is allowed for by assuming an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four-week period.

2

Subject to a floor of zero for Asia and US interest rates.

3

Allowing for further transitional measures recalculation after the interest rate stress.

4

US Risk Based Capital solvency position included using a stress of 10 times expected credit defaults.

The Group believes it is positioned to withstand significant deteriorations in market conditions and we continue to use market hedges to manage some of this exposure across the Group, where we believe the benefit of the protection outweighs the cost. The sensitivity analysis above allows for predetermined management actions and those taken to date, but does not reflect all possible management actions which could be taken in the future.

UK Solvency II capital position^{1, 2}

On the same basis as above, the estimated shareholder Solvency II surplus for The Prudential Assurance Company Limited ('PAC') and its subsidiaries² at 31 December 2018 was £3.7 billion, after allowing for recalculation of transitional measures as at 31 December 2018. This relates to shareholder-backed business including future with-profits shareholder transfers, but excludes the shareholders' share of the estate in line with Solvency II requirements.

| Estimated UK shareholder Solvency II capital position* | 31 Dec 2018 | 31 Dec 2017 |
|--|-------------|-------------|
| Own Funds (£bn) | 8.8 | 14.0 |
| Solvency Capital Requirement (£bn) | 5.1 | 7.9 |
| Surplus (£bn) | 3.7 | 6.1 |
| Solvency ratio (%) | 172% | 178% |

*

The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

The Prudential Assurance Company Limited shareholder Solvency II position at 31 December 2018 includes the actual impact of the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited, and the impact of the reinsurance of £12.0 billion of the UK annuity portfolio to Rothesay Life. In total these items have resulted in a decrease to UK Solvency II surplus in 2018 of £3.3 billion.

Upon completion of the Part VII transfer a further circa £0.1 billion of Solvency Capital Requirement is expected to be released.

Whilst there is a large surplus in the UK with-profits funds, this is ring-fenced from the shareholder balance sheet and is therefore excluded from both the Group and the UK shareholder Solvency II surplus results. The estimated UK with-profits funds Solvency II surplus at 31 December 2018 was £5.5 billion, after allowing for recalculation of transitional measures as at 31 December 2018.

| Estimated UK with-profits Solvency II capital position* | 31 Dec 2018 | 31 Dec 2017 |
|---|-------------|-------------|
| Own Funds (£bn) | 9.7 | 9.6 |
| Solvency Capital Requirement (£bn) | 4.2 | 4.8 |
| Surplus (£bn) | 5.5 | 4.8 |
| Solvency ratio (%) | 231% | 201% |

*

The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

Reconciliation of UK with-profits IFRS unallocated surplus to Solvency II Own Funds¹

A reconciliation between the IFRS unallocated surplus and Solvency II Own Funds for UK with-profits business is as follows:

| Reconciliation of UK with-profits funds | 31 Dec 2018 £bn | 31 Dec 2017 £bn |
|---|-----------------|-----------------|
| IFRS unallocated surplus of UK with-profits funds | 13.3 | 13.5 |
| Value of shareholder transfers | (2.4) | (2.7) |
| Risk margin (net of transitional measures) | (1.0) | (0.7) |
| Other valuation differences | (0.2) | (0.5) |
| Estimated Solvency II Own Funds | 9.7 | 9.6 |

Annual regulatory reporting

The Group will publish its Solvency and Financial Condition Report and related quantitative templates no later than 4 June 2019. The templates will require us to combine the Group shareholder solvency position with those of all other ring fenced funds across the Group. In combining these solvency positions, the contribution to own funds from these ring fenced funds will be set equal to their aggregate solvency capital requirements, estimated at £5.6 billion (ie the solvency surplus in these ring fenced funds will not be captured in the templates). There will be no impact on the reported Group Solvency II surplus.

Statement of independent review in respect of Solvency II Capital Position at 31 December 2018

The methodology, assumptions and overall result have been subject to examination by KPMG LLP.

Notes

1

The UK with-profits capital position includes the PAC with-profits sub-fund, the Scottish Amicable Insurance Fund and the Defined Charge Participating Sub-Fund.

2

The insurance subsidiaries of PAC are Prudential International Assurance plc and Prudential Pensions Limited. Prudential General Insurance Hong Kong Limited and Prudential Hong Kong Limited are no longer subsidiaries of PAC following the transfer of these Hong Kong subsidiaries to Prudential Corporation Asia Limited in 2018.

III

Calculation of alternative performance measures

The annual report uses alternative performance measures (APMs) to provide more relevant explanations of the Group's financial position and performance. This section sets out explanations for each APM and reconciliations to relevant IFRS balances.

III(a)

Reconciliation of adjusted IFRS operating profit based on longer-term investment returns to profit before tax

The annual report uses alternative performance measures (APMs) to provide more relevant explanations of the Group's financial position and performance. This section sets out explanations for each APM and reconciliations to relevant IFRS balances.

Adjusted IFRS operating profit attributable to shareholders based on longer-term investment returns presents the operating performance of the business. This measurement basis adjusts for the following items within total IFRS profit before tax:

–

Short-term fluctuations in investment returns on shareholder-backed business;

–

Amortisation of acquisition accounting adjustments arising on the purchase of business; and

–

Gain or loss on corporate transactions, such as disposals undertaken in the year.

More details on how adjusted IFRS operating profit based on longer-term investment returns is determined are included in note B1.3 of the IFRS financial statements.

III(b)

Calculation of return on IFRS shareholders' funds

Return on IFRS shareholders' funds is calculated as operating profit based on longer-term investment returns net of tax and non-controlling interests divided by opening shareholders' funds. Operating profit based on longer-term investment returns is reconciled to IFRS profit before tax in note B1 to the IFRS financial statements.

| | Note | 2018 £m | 2017 £m |
|--|------|---------|---------|
| Operating profit based on longer-term investment returns | B1.1 | 4,827 | 4,699 |
| Tax on operating profit | | (792) | (971) |
| Profit attributable to non-controlling interests | | (3) | (1) |
| Operating profit based on longer-term investment returns, net of tax and non-controlling interests | | 4,032 | 3,727 |
| Opening shareholders' funds | | 16,087 | 14,666 |
| Return on shareholders' funds | | 25% | 25% |

III(c)

Calculation of IFRS gearing ratio

Gearing ratio is calculated as net core structural borrowings of shareholder-financed operations divided by closing IFRS shareholders' funds plus net core structural borrowings.

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| | Note | 31 Dec 2018 £m | 31 Dec 2017 £m |
|---|-------|----------------|----------------|
| Core structural borrowings of shareholder-financed operations | C6.1 | 7,664 | 6,280 |
| Less holding company cash and short-term investments | II(a) | (3,236) | (2,264) |
| Net core structural borrowings of shareholder-financed operations | | 4,428 | 4,016 |
| Closing shareholders' funds | | 17,249 | 16,087 |
| Shareholders' funds plus net core structural borrowings | | 21,677 | 20,103 |
| Gearing ratio | | 20% | 20% |

III(d)

Calculation of IFRS shareholders' funds per share

IFRS shareholders' funds per share is calculated as closing IFRS shareholders' funds divided by the number of issued shares at the balance sheet date.

| | Note | 31 Dec 2018 | 31 Dec 2017 |
|--|------|-------------|-------------|
| Closing shareholders' funds (£ million) | | 17,249 | 16,087 |
| Number of issued shares at year end (millions) | C10 | 2,593 | 2,587 |
| Shareholders' funds per share (pence) | | 665 | 622 |

III(e)

Calculation of asset management cost/income ratio

The asset management cost/income ratio is calculated as asset management operating expenses, adjusted for commission and joint venture contribution, divided by asset management total IFRS revenue adjusted for commission, joint venture contribution, performance-related fees and non-operating items.

| | M&GPrudential asset management | |
|--|-----------------------------------|---------|
| | 2018 £m | 2017 £m |
| Operating income used in cost/income ratio | 1,100 | 1,034 |
| Commission | 313 | 351 |
| Performance-related fees | 15 | 53 |
| Investment Return | (14) | – |
| Short-term fluctuations in investment returns on shareholder backed business | (15) | 6 |
| Total IFRS revenue | 1,399 | 1,444 |
| Operating expense used in cost/income ratio | 654 | 602 |
| Investment Return | (14) | – |
| Commission | 313 | 351 |
| IFRS charges | 953 | 953 |
| Cost/income ratio – Operating expense/operating income | 59% | 58% |
| | Eastspring Investments | |
| | 2018 £m | 2017 £m |
| Operating income before performance-related fees used in cost/income ratio | 424 | 421 |
| Share of joint venture revenue | (188) | (176) |
| Commission | 118 | 103 |
| Performance-related fees | 17 | 17 |
| Total IFRS revenue | 371 | 365 |

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| | | |
|--|-------|------|
| Operating expense used in cost/income ratio | 232 | 238 |
| Share of joint venture expense | (100) | (92) |
| Commission | 118 | 103 |
| IFRS charges | 250 | 249 |
| Cost/income ratio – Operating expense/operating income before performance-related fees | 55% | 56% |

III(f)

Reconciliation of Asia renewal insurance premium to gross earned premiums

Asia renewal insurance premium is calculated as IFRS gross earned premiums less new business premiums and adjusted for the contribution from joint ventures.

| | Note | 2018 £m | AER 2017 £m | CER 2017 £m |
|---|------|---------|----------------|----------------|
| Asia renewal insurance premium | | 12,856 | 11,482 | 11,087 |
| Add: General insurance premium | | 90 | 89 | 87 |
| Add: IFRS gross earned premium from new regular and single premium business | | 4,809 | 4,986 | 4,819 |
| Less: Renewal premiums from joint ventures | | (1,286) | (1,068) | (1,022) |
| Add: premiums relating to sold Korea life business | | – | 199 | 197 |
| Asia segment IFRS gross earned premium | B1.4 | 16,469 | 15,688 | 15,168 |

III(g)

Reconciliation of APE new business sales to earned premiums

The Group reports APE new business sales as a measure of the new policies sold in the year. This differs from the IFRS measure of premiums earned as shown below:

| | Note | 2018 £m | 2017 £m |
|---|------|----------|------------|
| Annual premium equivalents as published | | 6,802 | 6,958 |
| Adjustment to include 100% of single premiums on new business sold in the year note (i) | | 28,009 | 28,769 |
| Premiums from in-force business and other adjustments note (ii) | | 12,413 | 8,278 |
| Gross premiums earned | B1.4 | 47,224 | 44,005 |
| Outward reinsurance premiums note (iii) | B1.4 | (14,023) | (2,062) |
| Earned premiums, net of reinsurance as shown in the IFRS financial statements | B1.4 | 33,201 | 41,943 |

Notes

(i)
APE new business sales only include one tenth of single premiums, recorded on policies sold in the year. Gross premiums earned include 100 per cent of such premiums.

(ii)
Other adjustments principally include amounts in respect of the following:

-
Gross premiums earned include premiums from existing in-force business as well as new business. The most significant amount is recorded in Asia, where a significant portion of regular premium business is written. Asia in-force premiums form the vast majority of the other adjustment amount;

-
In October 2018, Jackson entered into a 100 per cent reinsurance agreement with John Hancock Life Insurance Company to acquire a closed block of group pay-out annuity business. The transaction resulted in an addition to gross

premiums earned of £3.7 billion. No amounts were included in APE new business sales.

-

APE includes new policies written in the year which are classified as investment contracts without discretionary participation features under IFRS 4, arising mainly in Jackson for guaranteed investment contracts and in M&GPrudential for certain unit-linked savings and similar contracts. These are excluded from gross premiums earned and recorded as deposits;

-

APE new business sales are annualised while gross premiums earned are recorded only when revenues are due; and

-

For the purpose of reporting APE new business sales, we include the Group's share of amounts sold by the Group's insurance joint ventures and associates. Under IFRS, joint ventures and associates are equity accounted and so no amounts are included within gross premiums earned.

(iii)

Outward reinsurance premiums in 2018 include £(12,149) million in respect of the reinsurance of the UK annuity portfolio.

III(h)

Reconciliation between IFRS and EEV shareholders' funds

The table below shows the reconciliation of EEV shareholders' funds and IFRS shareholders' funds at the end of the year:

| | 31 Dec 2018 £m | 31 Dec 2017 £m |
|---|----------------|----------------|
| EEV shareholders' funds | 49,782 | 44,698 |
| Less: Value of in-force business of long-term businessnote (i) | (33,013) | (29,410) |
| Deferred acquisition costs assigned zero value for EEV purposes | 10,077 | 9,227 |
| Othernote (ii) | (9,597) | (8,428) |
| IFRS shareholders' funds | 17,249 | 16,087 |

Notes

(i)

The EEV shareholders' funds comprises the present value of the shareholders' interest in the value of in-force business, net worth of long-term business operations and IFRS shareholders' funds of asset management and other operations. The value of in-force business reflects the present value of future shareholder cash flows from long-term in-force business which are not captured as shareholders' interest on an IFRS basis. Net worth represents the net assets for EEV reporting purposes that reflect the regulatory basis position, sometimes with adjustments to achieve consistency with the IFRS treatment of certain items.

(ii)

Other adjustments represent asset and liability valuation differences between IFRS and the local regulatory reporting basis used to value net worth for long-term insurance operations. For the UK, this would be the difference between IFRS and Solvency II.

It also includes the mark to market of the Group's core structural borrowings which are fair valued under EEV but not IFRS. The most significant valuation differences relate to changes in the valuation of insurance liabilities. For example, in Jackson where IFRS liabilities are higher than the local regulatory basis as they are principally based on policyholder account balances (with a deferred acquisition costs recognised as an asset) whereas the local regulatory basis used for EEV is based on future cash flows due to the policyholder on a prudent basis with consideration of an expense allowance as applicable, but with no separate deferred acquisition cost asset.

III(i)

Reconciliation of EEV operating profit based on longer-term investment returns

To the extent applicable, the presentation of the EEV post-tax profit for the year is consistent in the classification between operating and non-operating results with the basis that the Group applies for the analysis of IFRS basis results. Operating results reflect underlying results including longer-term investment returns, which are determined following the EEV Principles issued by the European Insurance CFO Forum.

Non-operating results comprise:

-
- Short-term fluctuations in investment returns;
-
- The mark to market value movements on core structural borrowings;
-
- The effect of changes in economic assumptions; and
-
- The impact of corporate transactions undertaken in the year.

More details on how EEV post-tax profit is determined and the components of EEV operating profit are included in note 13 of the EEV supplementary basis of results.

III(j)

Calculation of return on embedded value

Return on embedded value is calculated as the EEV post-tax operating profit based on longer-term investment returns, as a percentage of opening EEV basis shareholders' funds.

| | 2018 | 2017 |
|--|--------|--------|
| EEV operating profit based on longer-term investment returns (£ million) | 7,563 | 6,598 |
| Opening EEV basis shareholders' funds (£ million) | 44,698 | 38,968 |
| Return on embedded value (%) | 17% | 17% |

III(k)

Calculation of EEV shareholders' funds per share

EEV shareholders' funds per share is calculated as closing EEV shareholders' funds divided by the number of issued shares at the balance sheet date. EEV shareholders' funds per share excluding goodwill attributable to shareholders is calculated in the same manner, except goodwill attributable to shareholders is deducted from closing EEV shareholders' funds.

| | 31 Dec 2018 | 31 Dec 2017 |
|---|-------------|-------------|
| Closing EEV shareholders' funds (£ million) | 49,782 | 44,698 |
| Less: Goodwill attributable to shareholders (£ million) | (1,651) | (1,458) |
| Closing EEV shareholders' funds excluding goodwill attributable to shareholders (£ million) | 48,131 | 43,240 |
| Number of issued shares at year end (millions) | 2,593 | 2,587 |
| Shareholders' funds per share (in pence) | 1,920p | 1,728p |
| Shareholders' funds per share excluding goodwill attributable to shareholders (in pence) | 1,856p | 1,671p |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: 13 March 2019

PRUDENTIAL PUBLIC LIMITED COMPANY

By: /s/ Mark FitzPatrick

Mark FitzPatrick
Chief Financial Officer