PRUDENTIAL PLC Form 20-F March 24, 2017 Table of Contents

As filed with the Securities and Exchange Commission on 24 March 2017

#### **UNITED STATES**

#### SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

#### **FORM 20-F**

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

OR

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

For the fiscal year ended 31 December 2016

OR

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

OR

# SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**Commission File Number: 1-15040** 

#### PRUDENTIAL PUBLIC LIMITED COMPANY

(Exact Name of Registrant as Specified in its Charter)

#### **England and Wales**

(Jurisdiction of Incorporation)

12 Arthur Street,

London EC4R 9AQ, England

(Address of Principal Executive Offices)

Rebecca Wyatt

**Head of Financial Accounting** 

Prudential plc

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(Name, telephone, e-mail and/or facsimile number and address of company contact person)

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

Title of Each Class
American Depositary Shares, each representing
2 Ordinary Shares, 5 pence par value each
Ordinary Shares, 5 pence par value each

Name of Each Exchange on Which Registered New York Stock Exchange

New York Stock Exchange\*
New York Stock Exchange

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6.75% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non-Cumulative Dollar Denominated Preference Shares 6.50% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non-Cumulative Dollar Denominated Preference Shares Securities registered or to be registered pursuant to Sect	New York Stock Exchange tion 12(g) of the Act:
No	ne
Securities for which there is a reporting obligation purson No	
The number of outstanding shares of each of the issuer December 2016 was:  2,581, 061,973 Ordinary Shares	
Indicate by check mark if the registrant is a well-known Securities Act. $Yes \ \underline{X}$	·
If this report is an annual or transition report, indicate I reports pursuant to Section 13 or 15(d) of the Securities  Yes	by check mark if the registrant is not required to file Exchange Act of 1934.
Indicate by check mark whether the registrant: (1) has f 15(d) of the Securities Exchange Act of 1934 during the the registrant was required to file such reports) and (2) past 90 days.	preceding 12 months (or for such shorter period that

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Yes <u>X</u> No \_\_

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

Y	Yes I	No			
Indicate by check mark whether the registrant is non-accelerated filer. See definition of accelera Exchange Act. (Check one):	_			·	e
Large accelerated filer X A	Accelerated f	iler No	on-accelerated	l filer	
Indicate by check mark which basis of accounting included in this filing:	ng the regis	trant has used	to prepare tl	he financial staten	nent
U.S. GAAP International Financial Reportin B	g Standards Board <u>X</u> Otl		e Internationa	al Accounting Stand	dard
If Other has been checked in response to the statement item the registrant has elected to follo		estion, indicat	te by check m	ark which financi	ial
Item	17 <u> </u>	tem 18			
If this is an annual report, indicate by check ma Rule 12b-2 of the Exchange Act).	rk whether	the registrant	is a shell con	npany (as defined	in
Y	Yes N	No <u>X</u>			
* Not for trading, but only in connection with the	registration	of American I	Depositary Sha	ares.	

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

Portions of the Prudential s Annual Report 2016 incorporated by reference herein contain references to our website. Information on our website or any other website referenced in the Prudential Annual Report 2016 is not incorporated into this Form 20-F and should not be considered to be part of the Form 20-F. We have included any website as an inactive textual reference only.

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

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

#### **Selected Historical Financial Information of Prudential**

The following table sets forth selected consolidated financial data for Prudential for the periods indicated. Certain data is derived from Prudential s audited consolidated financial statements prepared in accordance with International Financial Reporting Standards ( IFRS ) as issued by the International Accounting Standards Board ( IASB ) and as endorsed by the European Union ( EU ). EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2016, there were no unendorsed standards effective for the years presented below affecting the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, the selected consolidated financial data presented below that is derived from Prudential s audited consolidated financial statements is derived from audited consolidated financial statements prepared in accordance with IFRS as issued by the IASB. This table is only a summary and should be read in conjunction with Prudential s consolidated financial statements and the related notes included elsewhere in this document, together with the disclosures in the Financial Performance section.

#### Income statement data

			Year ei	nded 31 Dec	ember	
	2016 \$m <sup>(1)</sup>	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Gross premium earned	48,091	38,981	36,663	32,832	30,502	29,113
Outward reinsurance premiums	(2,492)	(2,020)	(1,157)	(799)	(658)	(491)
Earned premiums, net of reinsurance	45,599	36,961	35,506	32,033	29,844	28,622
Investment return	40,109	32,511	3,304	25,787	20,347	23,931
Other income	2,924	2,370	2,495	2,306	2,184	1,885
Total revenue, net of reinsurance	88,631	71,842	41,305	60,126	52,375	54,438
Benefits and claims and movement in						
unallocated surplus of with-profits funds,						
net of reinsurance	(73,240)	(59,366)	(29,656)	(50,169)	(43,154)	(45,144)
Acquisition costs and other expenditure	(10,916)	(8,848)	(8,208)	(6,752)	(6,861)	(6,032)
Finance costs: interest on core structural						
borrowings of shareholder-financed						
operations	(444)	(360)	(312)	(341)	(305)	(280)
Remeasurement of carrying value of Korea						
life business classified as held for sale	(294)	(238)	-	-	-	
Disposal of Japan life business:						
Cumulative exchange loss recycled from						
other comprehensive income	-	-	(46)	-	-	-
Remeasurement adjustments	-	-	-	(13)	(120)	-
Total charges, net of reinsurance	(84,892)	(68,812)	(38,222)	(57,275)	(50,440)	(51,456)
Share of profits from joint ventures and						
associates, net of related tax	225	182	238	303	147	135
Profit before tax (being tax attributable to						
shareholders and policyholders						
returns) <sup>(2)</sup>	3,964	3,212	3,321	3,154	2,082	3,117
Tax charges attributable to policyholders						
returns	(1,156)	(937)	(173)	(540)	(447)	(370)

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Profit before tax attributable to						
shareholders	2,808	2,275	3,148	2,614	1,635	2,747
Tax credit (charge) attributable to						
shareholders returns	(437)	(354)	(569)	(398)	(289)	(584)
Profit for the year	2,370	1,921	2,579	2,216	1,346	2,163

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(In	2016 <sup>(1)</sup> \$m, except	2016	2015	2014	2013	2012
	formation)		£m, excep	t Share Info	rmation	
Statement of financial position data						
Total assets	580,453	470,498	386,985	369,204	325,932	307,644
Fotal policyholder liabilities and unallocated	,	,				
surplus of with-profits funds	497,567	403,313	335,614	321,989	286,014	268,263
Core structural borrowings of						
shareholder-financed operations	8,387	6,798	5,011	4,304	4,636	3,554
Total liabilities	562,359	455,831	374,029	357,392	316,281	297,280
Γotal equity	18,095	14,667	12,956	11,812	9,651	10,364
Other data						
Based on profit for the year attributable to the						
equity holders of the Company:						
Basic earnings per share (in pence)	92.5¢	75.0p	101.0p	86.9p	52.8p	85.1p
Diluted earnings per share (in pence)	92.5¢	75.0p	100.9p	86.8p	52.7p	85.0p
Dividend per share declared and paid in						
reporting period (in pence) <sup>(5)</sup>						
nterim ordinary dividend/final ordinary						
lividend	48.6¢	39.40p	38.05p	35.03p	30.52p	25.64p
Equivalent cents per share <sup>(6)</sup>		55.21¢	59.11¢	58.44¢	50.58¢	40.68¢
Special dividend	12.3¢	10.00p				
Equivalent cents per share <sup>(6)</sup>		14.51¢				
Market price per share at end of period <sup>(7)</sup>	2,007.8¢	1,627.5p	1,531.0p	1,492.0p	1,340.0p	865.5p
Weighted average number of shares (in millions)		2,560	2,553	2,549	2,548	2,541
New business:						
Single premium sales <sup>(3)</sup>	34,347	27,841	27,687	24,296	22,665	22,264
New regular premium sales <sup>(3)(4)</sup>	4,362	3,536	2,697	2,107	2,043	1,873
Funds under management	739,356	599,300	508,600	496,000	443,000	406,000

- (1) Amounts stated in US dollars in the 2016 US dollar column have been translated from pounds sterling at the rate of \$1.2337 per £1.00 (the noon buying rate in New York City on 30 December 2016).
- (2) This measure is the formal profit (loss) before tax measure under IFRS but is not the result attributable to shareholders. See Presentation of results before tax in note A3.1 to Prudential s consolidated financial statements for further explanation.
- (3) The new business premiums in the table shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders (see EEV basis, new business results and free surplus generation below). The amounts shown are not, and are not intended to be, reflective of premium income recorded in the IFRS income statement. Internal vesting business is classified as new business where the contracts include an open market option.

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

The new business premiums shown above, including the comparative figures, exclude the new business premiums from the Group s held for sale Korea life business. Korea life s new business premiums for the years ended 31 December 2016, 2015 and 2014 are shown in Our businesses Asia.

The Group did not write any bulk annuity business in the UK in 2016 as we withdrew from this market. The 2015 comparative single premium sales as shown above included premiums from UK bulk annuities of £1,508 million (2014: £1,710 million; 2013: £276 million; 2012: £408 million).

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

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- (5) Under IFRS, dividends declared or approved after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event. The appropriation reflected in the statement of changes in equity, therefore, includes dividend in respect of the prior year that was declared or approved after the balance sheet date of the prior reporting period. Parent company dividends relating to the reporting period were a first interim ordinary dividend of 12.93p per share in 2016 (2015: 12.31p, 2014: 11.19p), a second interim ordinary dividend of 30.57p per share in 2016 (2015: second interim ordinary dividend 26.47p, 2014: final ordinary dividend 25.74p) and a special dividend of 10.00p per share in 2015 only.
- (6) The dividends have been translated into US dollars at the noon buying rate in New York City on the date each payment was made.
- (7) Market prices presented are the closing prices of the shares on the London Stock Exchange on the last day of trading for each indicated period.

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## **Forward-Looking Statements**

This document may contain forward-looking statements with respect to certain of Prudential s plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential s beliefs and expectations and including, without limitation, statements containing the words may, will, should, continue, aims, estimates, projects, believes, intenplans, seeks and anticipates, and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore undue reliance should not be placed on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential s actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, future market conditions, including fluctuations in interest rates and exchange rates, the potential for a sustained low-interest rate environment, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives; the political, legal and economic effects of the UK s vote to leave the European Union; the impact of continuing designation as a Global Systemically Important Insurer or G-SII; the impact of competition, economic uncertainty, inflation and deflation; the effect on Prudential s business and results from, in particular, mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal and regulatory actions, investigations and disputes. These and other important factors may, for example, result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits, Further discussion of these and other important factors that could cause Prudential s actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential s forward-looking statements can be found under the Risk Factors heading of this annual report, as well as under the Risk Factors heading of any subsequent Prudential Half Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K.

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

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#### **Summary of Operating and Financial Review and Prospects**

The following discussion and analysis should be read in conjunction with Prudential s consolidated financial statements and the related notes to Prudential s consolidated financial statements included in this document.

A summary of the critical accounting policies which have been applied to these statements is set forth in the section below entitled IFRS Critical Accounting Policies .

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

Prudential has reported significant progress in 2016, reflecting our, successful strategy and the growing capabilities of the Group.

Our global scale, close understanding of our markets and constant drive to improve are continuing to create shared value for our customers and our shareholders.

Prudential exists to de-risk people s lives. Saving for a child s education, protecting people against the financial cost of ill-health or the death of a family s primary income earner, turning hard-earned savings into secure retirement income across all these areas we help to remove uncertainty from life s biggest financial events.

Our strategy is shaped around meeting those needs where they are greatest and where we have the capabilities to make the most significant impact. That is among the increasingly affluent population of Asia, who have a growing demand for the health and protection products we provide, and the ageing populations of the US and the UK, who are looking for ways to invest their savings to produce income for retirement.

This was another year of innovation, as we continue to improve and personalise our products to ensure they are tailored to the diverse financial needs of our customers. At the same time, we remain focused on the expansion of our distinctive distribution platforms, allowing us to reach new customers and better serve existing ones. Meanwhile, we continue to develop the investment capabilities of our asset management businesses and to invest in the systems and people to manage the risks we assume on behalf of our customers. We are also sowing the seeds for our future growth by investing in new markets.

#### **Currency volatility**

As in previous years, we comment on our performance in local currency terms (expressed on a constant exchange rate basis) to show the underlying business trends in a period of significant currency movements.

We have used this basis in discussions below for our Asian and US businesses to maintain comparability. Currency values in the countries in which we operate have fluctuated in the course of 2016. As a significant proportion of our earnings and capital is US dollar denominated, weaker sterling benefited our reported results, shareholders equity and solvency.

In 2014 we adopted the approach of evaluating the financial performance of the Group by presenting percentage growth rates before the impact of the fluctuations in the value of sterling against local currencies in the US and Asia. In a period of currency volatility this approach allows a more meaningful assessment of underlying performance

trends. This is because our businesses in the US and Asia receive premiums and pay claims in local currencies and are, therefore, not exposed to any cross-currency trading effects. To maintain comparability in the discussion below the same basis has been applied. Growth rates based on actual exchange rates are also shown in the financial tables presented in this report. Consistent with previous reporting periods, the assets and liabilities of our overseas businesses are translated at period-end exchange rates so the effect of currency movements has been fully incorporated within reported shareholders equity.

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The table below explains how the Group's profit after tax on an IFRS basis reconciles to profit before tax and the supplementary analysis of operating profit based on longer-term investment returns. Further explanation on the determination of operating profit based on longer-term investment returns is provided in the Basis of Performance Measures section. Further explanation on non-operating items is provided in the sub-section. IFRS non-operating items. The table presents the 2015 results on both an actual exchange rate and constant exchange rate basis so as to eliminate the impact of exchange translation. Actual Exchange Rates (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. Constant Exchange Rates (CER) results are calculated by translating prior period results using the current period foreign exchange rate is current period average rates for the income statement and current period closing rates for the balance sheet.

IFRS Profit						
	Actual Exchange Rate 2016 2015* Change			Constant Exchange Rate 2015* Change		Actual Exchange Rate 2014*
	£m	£m	%	£m	%	£m
Profit after tax for the year attributable to						
shareholders	1,921	2,579	(26)%	2,816	(32)%	2,216
Tax (credit)/charge attributable to shareholders						
returns	354	569	(38)%	621	(43)%	398
Profit before tax attributable to shareholders	2,275	3,148	(28)%	3,437	(34)%	2,614
Non-operating items:						
Losses/(gains) from short-term fluctuations in						
investment returns	1,678	755	122%	827	103%	605
Other non-operating expense/(income)	76	122	(38)%	131	(42)%	(2)
Loss/(profit) attaching to held for sale Korea						
business	227	(56)	n/a	(62)	n/a	(63)
	1,981	821	141%	896	121%	540
Operating profit before tax based on						
longer-term investment returns	4,256	3,969	7%	4,333	(2)%	3,154
Analysed into:						
Asia	1,644	1,286	28%	1,431	15%	1,108
US	2,048	1,702	20%	1,921	7%	1,443
UK	828	1,195	(31)%	1,195	(31)%	753
M&G	425	442	(4)%	442	(4)%	446
Prudential Capital	27	19	42%	19	42%	42
Other income and expenditure	<b>(716)</b>	(675)	(6)%	(675)	(6)%	(661)
Results of the sold PruHealth and PruProtect						
business	-	-	n/a	-	-	23
Operating profit before tax based on						
longer-term investment returns	4,256	3,969	7%	4,333	(2)%	3,154

<sup>\*</sup>To facilitate future comparisons of operating profit based on longer-term investment returns that reflect the Group s retained operations, the results attributable to the held for sale Korea life business are included separately within the supplementary analysis of profit above.

In the remainder of this section every time we comment on the performance of our businesses, (except with respect to cash remittances), we focus on their performance measured in local currency (presented here by reference to percentage growth expressed at constant exchange rates) unless otherwise stated. In each such case, the performance of our businesses in actual exchange rate terms is explained by the same factors discussed in the comments below and the impact of currency movements implicit in the CER data.

### **Group performance**

Profit for the year after tax for 2016 was £1,921 million compared with £2,579 million for 2015 (AER basis). The decrease primarily reflects the movement in profit before tax attributable to shareholders, which reduced from a profit of £3,148 million in 2015 (on an AER basis) to a profit of £2,275 million in 2016, which was partially offset by a decrease in the tax charge attributable to shareholders from £569 million in 2015 to £354 million in 2016.

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On an actual exchange rate basis, the decrease in the total profit before tax attributable to shareholders from £3,148 million in 2015 to £2,275 million in 2016 reflects an improvement in operating profit based on longer-term investment returns of £287 million or 7 per cent, which was more than offset by an adverse change in non-operating items of £1,160 million, from a loss of £821 million to a loss of £1,981 million. The improvement of £287 million in total operating profit based on longer term investment returns on an actual exchange rate basis reflects an increase in Asia (from £1,286 million to £1,644 million) and the US (from £1,702 million to £2,048 million) partially offset by a decrease in the UK operating profit based on longer-term investment returns (from £1,195 million to £828 million), an increase in M&G operating profit based on longer-term investment returns (from £442 million to £425 million) and increase in Prudential Capital operating profit based on longer-term investment return (from £19 million to £27 million) and an increase in loss from other income and expenditure (from a loss of £675 million to £716 million). The increase of £287 million or 7 per cent in total operating profit based on longer-term investments includes a positive exchange translation impact of £364 million. Excluding the effect of currency volatility, on a constant exchange rate basis, total operating profit based on longer-term investment returns decreased from £4,333 million to £4,256 million

Prudential has delivered a strong financial performance in 2016, led by growth in Asia. In a year that has seen continued low interest rates, market volatility and dramatic political change, our results continue to benefit from the scale and diversity of the Group s global platform, the disciplined execution of our strategy and the strength of the opportunities in our target markets.

Our operational agility and broad business mix mean we are able to continually flex our approach in response to local market conditions and opportunities without compromising our overall near-term financial performance. These characteristics have recently been particularly evident in our businesses in Asia, which continue to drive the growth of the Group and in 2016 achieved double-digit increases across all of our major metrics. This was despite deliberate pricing and product actions to protect profitability of some market segments where returns were no longer sufficiently attractive given the low-interest-rate environment. We always seek the appropriate balance between value and volume.

Group operating profit based on longer-term investment returns was 2 per cent<sup>1</sup> lower at £4,256 million (up 7 per cent on an actual exchange rate basis). Our businesses in Asia and the US generated growth of 15 per cent<sup>1</sup> and 7 per cent respectively, while the contribution from our UK-based businesses reduced by 23 per cent. Here, as expected, the overall result was impacted by the effect of negative fund flows at M&G, our deliberate withdrawal from the UK bulk annuity market as returns ceased to be attractive and a lower contribution from UK capital optimisation actions. The result also includes a provision for the cost of undertaking a review in the UK of past non-advised annuity sales practices and related potential redress.

Prudential s growing in-force business continues to support our overall cash generation. Cash remittances to the Group were also higher at £1,718 million, supporting the 12 per cent increase in the 2016 full year ordinary dividend to 43.5 pence per share. Since 2012 Prudential has made total payments to shareholders of £4.6 billion, highlighting the underlying growth and cash-generative nature of the business.

The Group continues to operate with a strong capital position, ending the year with a Solvency II cover ratio<sup>3</sup> of 201 per cent<sup>2</sup>. Over the period, IFRS shareholders funds increased by 13 per cent to £14.7 billion after taking into account profit after tax of £1,921 million (2015: £2,579 million on an actual exchange rate basis) and other movements including positive foreign exchange movements of £1.2 billion.

During 2016, we have strengthened our position as a diversified global Group delivering long-term value to customers and shareholders.

In Asia, we are developing our operations, through the quality of our business and through our scale. Underpinning the outlook for Asia earnings, our new regular-premium income and life in-force weighted premium income have both increased strongly. In addition, our Asian asset manager, Eastspring Investments, has grown, with overall assets under management reaching £117.9 billion at the year end, a new high.

In the US we are well positioned to navigate a period of significant regulatory change, including the currently scheduled introduction of the Department of Labor s fiduciary duty rule. The product innovation that is in train to address the new regulatory requirements, coupled with our sector-leading IT and servicing capabilities, enables us to access sizeable retirement asset pools that were previously not open to Jackson.

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The demographic shift occurring in the US is a significant long-term driver of demand for the types of products that we offer. In 2016, through this period of disruption, Jackson s separate account assets relating to its variable annuity business, and the main driver of earnings, increased by 11 per cent to US\$148.8 billion.

In the UK, where we are seeing a large amount of change in the marketplace along with the introduction of new capital rules, we are also adapting well. PruFund sales growth continues to outperform the market, and our retail sales are now higher than before the Retail Distribution Review. During this period of change we remain focused on delivering high-quality products to meet our customers—evolving needs. The FCA—s thematic review of non-advised annuity sales practices showed that, in a portion of annuity sales that the UK business made since July 2008, it was not adequately explained to customers that they may have been eligible for an enhanced annuity. We are continuing to work to ensure we put things right.

Also in the UK, at M&G, we are focused on careful management of costs and improving performance. In 2016, assets managed by M&G on behalf of external clients increased by 8 per cent to £137 billion, with internal assets taking the total to £265 billion (2015: £246 billion).

#### 2017 Objectives

We announced objectives for 2017 at our investor conference in December 2013 in London focused on underlying free surplus generation<sup>4</sup> at the Group level and in Asia and growth of Asia life and asset management pre-tax operating profit based on longer-term investment returns.

We have made good progress towards our 2017 objectives.

#### Our strategy

We have a clear, consistent strategy focused on three parts of the world where the needs of customers for the products we provide are not fully met.

In Asia we aim to meet the savings, accumulation, health and protection needs of the fast-growing and increasingly affluent middle class. As this group of people grows, so does their demand for goods and services. As an example, three-quarters of China s total population is forecast to be defined as middle income by 2030. The growing purchasing power of this section of the society is evident today. To illustrate, 60 million people left China for leisure travel purposes in 2011, but by last year this had doubled to 120 million and by 2020 is expected to top 200 million. Similarly last year Asian consumers bought around half of all the cars sold in the world, up from an average of less than 20 per cent during the 1990s.

The region s consumer spending growth is remarkable, but what is closest to the hearts of people in Asia, as anywhere else, is providing a secure and more prosperous future for their loved ones. This is creating a powerful and largely unmet demand for the products we provide. Asia has low insurance penetration, high out-of-pocket healthcare spend and rapidly growing private wealth. The working age population in the region is predicted to rise by 178 million by 2030. Mutual fund penetration rates are currently just 12 per cent in Asia, compared with 75 per cent in Europe and 96 per cent in the US, and there is a significant mortality protection gap.

We are a leading pan-regional franchise in Asia, we hold top-three positions in nine of our 12 life markets in the region, and we are the number one Asian retail asset manager<sup>7</sup>. We have the presence, scale, distribution and product capabilities to tap into the growing needs of our Asian customers.

The US is the largest<sup>10</sup> retirement savings market in the world, and over the next 20 years Americans will be retiring at a rate of 10,000 per day<sup>11</sup>. At the same time, private defined-benefit pension plans are disappearing and government plans are underfunded, life expectancy at age 65 has increased significantly, and individual investors struggle to capture returns and are exposed to volatile equity markets. The confluence of these trends is precipitating an expansion of the retirement market and a flight to quality that is aligned with Jackson s capabilities.

In the UK, an ageing population that does not have enough saved for the future is driving increasing demand for savings and retirement income products, and this demand has been reinforced by the pensions freedom changes. This is creating significant opportunities for our UK businesses that both Prudential UK and M&G are addressing through their long-term savings solutions and investment strategies.

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## Our capabilities

We believe we have a great strategy, but any strategy is only as good as its implementation. We are executing our strategy with discipline and continually developing our capabilities.

Across our markets, we are constantly innovating to improve the way we do business. During 2016, we added a number of new products and services to the successful range we offer around the world. In Asia, to take just two examples, Prudential Singapore became the first insurer in its market to launch an online community portal, where customers can share ideas and suggestions to help us improve our products and services, and Prudential Hong Kong gave customers access to an innovative DNA-based health and nutrition programme, demonstrating how we are building our capabilities to partner with customers to help improve their long-term health and wellbeing. We also expanded our reach in the region during 2016, by launching a new operation in Laos.

In the US, Jackson launched its first fee-based variable annuity, designed to meet the need for products compatible with the Department of Labor s fiduciary duty rule. In the UK retail market we introduced the Prudential Retirement Account, an online account-based plan that offers both accumulation and decumulation for customers near retirement and has proved extremely popular. M&G added a number of new funds, including its Global Target Return Fund and Absolute Return Bond Fund, helping customers deal with market volatility.

Our distribution capability is another of our key strengths. In 2016, we made good progress in improving our distribution platform throughout our markets. In Asia, productivity within our network of agents improved. The total number of agents across all our Asian markets is more than 500,000. We also continued to leverage the strength of our relationships with our bank partners, which has allowed us to ensure the appropriate balance between value and volume. We have access to more than 10,000 active bank branches through a total of three regional, five strategic and a variety of local partnerships. In the US, our variable annuity wholesale distribution platform is now more than 60 per cent larger<sup>8</sup> than that of our nearest competitor, and with greater<sup>8</sup> wholesaler productivity.

In the UK, the number of our adviser firms has grown by 37 per cent since 2013, and Prudential Financial Planning, our UK advisory business, has grown to become a top-10 UK advisory business, from its inception in 2012. In 2016 M&G, whose products are now registered in 23 jurisdictions around the world, established a new SICAV fund range in Luxembourg as a platform for future international distribution. At the same time, we entered Zambia, our fourth market in Africa. In less than three years, we have built our African business to the point where it has 1,750 agents, is active in 181 bank branches and has over 160,000 customers, with a further 1.5 million micro-insurance customers through partnerships with mobile phone operators and micro-finance institutions.

Our proven investment performance track record is another vital part of our capability. Across our asset management businesses we offer a range of funds that give investors the opportunity to benefit from a long-term, diversified approach, helping to deliver sustainable investment performance regardless of short-term market fluctuations. M&G has a long-standing track record of superior investment performance, with 85 per cent<sup>5</sup> of retail assets under management above median over the tenure of the fund manager. Likewise, the proportion of Eastspring s funds outperforming the median on a three-year period basis was 65 per cent<sup>6</sup>. In the UK, over the last 10 years our highly regarded PruFund investment option has delivered growth of 75 per cent, compared with a total return of 39 per cent for a benchmark ABI mixed investment fund. In the US, the number of funds within Jackson s living benefit variable annuity product that delivered a three-year annualised return, over the period 2014-16, of over 7 per cent was twice the number of funds within the top 12 peer products combined<sup>9</sup>.

We are also using the Group s scale to improve our risk management capabilities, including investing in new technology. In 2016 this included commencing implementation of Aladdin, a global risk and portfolio management

platform for our asset management businesses, which will help to simplify reporting systems and support future growth.

## Our outlook

Our growth prospects are based on clear long-term opportunities in the three markets we are targeting. There are historic demographic shifts taking place in these economies, and we are focused on ensuring that our capabilities develop in line with the evolving needs and preferences of our customers.

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We have demonstrated our ability to manage through times of economic uncertainty and market volatility, conditions that appear likely to prevail for some time. Our strategy is clear, the demand from customers for our products is strong and our execution is good and getting better. We are well positioned to continue to deliver value for both our customers and our shareholders.

- <sup>1</sup> Following its reclassification to held for sale during 2016, operating results exclude the contribution of the Korea life business. The 2015 comparative results have been similarly adjusted.
- <sup>2</sup> Estimated before allowing for second interim ordinary dividend.
- <sup>3</sup> The Group Solvency II surplus represents the shareholder capital position excluding 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 position includes the impact of recalculated transitionals at the valuation date which has reduced the Group shareholder surplus from £12.9 billion to £12.5 billion. The formal Quantitative Reporting Templates (Solvency II regulatory templates) will include transitional measures without this recalculation.
- <sup>4</sup> Underlying free surplus generated comprises underlying free surplus generated from long-term business (net of investment in new business) and that generated from asset management operations. Underlying free surplus is defined in the section EEV Basis, New Business Results and Free Surplus Generation .
- <sup>5</sup> Investment performance is as at 31 December 2016 and reflects 33 Retail funds representing 85 per cent of M&G Retail funds under management which have delivered top or upper quartile performance over fund manager tenure which is an average of 6 years. Quartile rankings are based on returns which are net of fees.
- <sup>6</sup> Blended score representing 50 per cent by number of funds and 50 per cent assets under management outperforming benchmark or in top two quartiles over three-year period.
- Ource: Asia asset management September 2016 (Ranked according to participating regional players only). Based on assets sourced from the region, excluding Japan, Australia and New Zealand as at June 2016.
- <sup>8</sup>Market Metrics Variable Annuity Sales, Staffing and Productivity Report: Q3 2016.
- <sup>9</sup> Jackson analysis based on Morningstar fund performance information as at 4Q YTD 2016, ranked by sales as of end Q3 2016. ©2017 Morningstar Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. Morningstar www.AnnuityIntel.com.
- <sup>10</sup> Cerulli Associates Advisor Metrics 2016.
- <sup>11</sup>Social Security Administration, Annual Performance Plan for FY 2012 and Revised Final Performance Plan for FY 2011.

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## **Our Strategy**

We meet the long-term savings and protection needs of an increasingly self-reliant population. We focus on three markets Asia, the US and the UK where the need for our products is strong and growing and we use our capabilities, footprint and scale to meet that need.

We aim to capture three long-term opportunities across our key geographical markets:

serving the protection and investment needs of the growing middle class in Asia; providing asset accumulation and retirement income products to US baby boomers; and meeting the savings and retirement needs of an ageing British population

Together with capturing the scale and diversification benefits of our global presence, we aim to generate attractive returns, enabling us to provide financial security to our customers, invest in growth opportunities and meet our customers high expectations.

#### What we offer

We focus on long-term opportunities in each of our geographical markets, understanding the needs of local customers and offering innovative products to meet those needs.

Life insurance Asset management

24m+ £383bn

Life customers worldwide

We provide our customers with savings products and financial protection against ill-health, loss of income and other adverse events, helping them to de-risk their lives Total funds under management We provide a range of opportunities across asset classes, generating valuable returns for our customers through a long-term approach to investment.

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## Where We Operate

Prudential plc is an international financial services group serving around 24 million insurance customers and with £599 billion of assets under management. Prudential is listed on stock exchanges in London, Hong Kong, Singapore and New York. It has been in existence for more than 168 years.

Prudential is the parent company of the Prudential group (the Prudential Group or the Group ). Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

We identify markets where the needs we meet are underserved. Our business is organised into four geographic regions, with a focus on Asia, the US and the UK, where we see structural demand for our products. In recent years we have expanded into Africa, taking advantage of the emerging demand for our products in the region.

#### Key geographic regions and our businesses

#### Asia

Prudential Corporation Asia has leading insurance and asset management operations across 14 markets and serves the emerging middle class families of the region s high-potential economies. We have been operating in Asia for over 90 years and have built high-performing businesses with multichannel distribution, a product portfolio centred on regular savings and protection, award-winning customer services and a widely recognised brand.

Eastspring Investments is a leading asset manager in Asia and provides investment solutions across a broad range of asset classes.

#### US

Jackson provides retirement savings and income strategies aimed at the large number of people approaching retirement in the United States. Jackson s pursuit of excellence in product innovation and distinctive distribution capabilities have helped us forge a solid reputation for meeting the needs of customers. Jackson s variable annuities offer a distinctive retirement solution designed to provide a variety of investment choices to help customers pursue their financial goals.

#### UK

#### Prudential UK & Europe

Prudential is a leading provider of savings and retirement income products in the UK. Our particular strength lies in investments that help customers meet their long-term goals, while also protecting them against short-term market fluctuations. We provide long-term savings solutions for UK customers, meeting people s needs through our core strengths in with-profits and retirement, underpinned by our expertise in areas such as longevity, risk management and multi-asset investment.

#### M&G

M&G Investments is an international asset manager with more than 85 years experience of investing on behalf of individuals and institutions. Our goal is to help our customers prosper by securing long-term returns from their savings. For individual investors, we offer funds across diverse geographies, asset classes and investment strategies

aimed at growing their long-term savings or producing regular income. For institutional investors, we offer investment strategies to meet their clients long-term needs for capital growth or income.

Africa

We entered into Africa in 2014 to offer products to new customers in one of the fastest-growing regions in the world. We aim to provide products that meet their needs towards saving for future expenses such as education for their children and to de-risk their financial lives.

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#### **Our Businesses**

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

#### Asia

#### Life Insurance

#### Introduction

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

As at 31 December 2016, Prudential Corporation Asia had:

over 14 million life insurance customers with life and fund management operations in 16 markets; distribution through more than 10,000 active bank branches across Asia with relationships including Standard Chartered Bank (SCB), United Overseas Bank Limited (UOB), ICICI Bank in India, CITIC in China and Thanachart in Thailand;

one of the largest networks of tied agents in Asia;

consistently high brand recognition, outperforming many other financial services companies and had received multiple awards for its customer service; and

a top 3 position in 9 out of the 12 life markets. (1)

(1) Prudential s rank in insurance market by new business. Based on formal (competitors results releases, local regulators, insurance associations) and informal (industry exchange) market share data.

#### Market overview

Asia s economic transformation started in the 1980s and the momentum remains strong. Although growth rates on a period-by-period basis can fluctuate due to the influence of macro economic and geopolitical factors, the unprecedented increases in personal wealth enjoyed by the growing number of Asian families will continue into the foreseeable future. Between 2010 and 2020 it is estimated that there will be over 700 million people who will have

risen from rural subsistence to more affluent lifestyles. Family profiles are changing too. Being able to finance children s education is a realistic goal, life expectancies are lengthening dramatically, the incidence of chronic diseases is increasing significantly and traditional family and community support networks are breaking down. All these factors can place significant stress on a family s finances.

The provision of personal financial security is one of the hallmarks of a successful society. Governments in the region appreciate this but typically only have appetites to provide rudimentary levels of state-sponsored healthcare and other social services. Consequently they are keen for individuals to take responsibility for their own financial well-being, address the health and protection gaps and establish savings plans towards their financial security.

While basic medical services may be provided by the state, there can be a high level of out-of-pocket expenses. Around 42 per cent of healthcare spend in the region is out-of-pocket, with this figure as high as 56 per cent in some markets, compared with 12 per cent in the US and 9 per cent in the UK. This creates strong demand for financial solutions to protect against the potentially devastating impacts of health-related incidents on a family s finances. Critical illness and medical riders are popular additions to life insurance policies in the region.

Insurance penetration remains low and prospects for protection-oriented insurance products remain high. Penetration rates vary by market in the region, which includes under-served markets such as Indonesia, the Philippines, Vietnam and Thailand, and better served ones like Singapore and Malaysia. While customer needs vary in each market, our product solutions are manufactured to serve the bespoke needs of each market and are distributed by our multi-channel distribution network.

As an individual s personal wealth increases, demand is created for savings and investment solutions that enable the individual to further increase that wealth and plan towards financial security. Around 60 per cent of Asians savings are held in unproductive cash, and the loss of compounded investment income that could be earned from putting these savings to work in the capital markets is material.

Prudential has been successful in identifying these opportunities and executing strategies in Asia that enable us to grow our business materially, meet customers needs and consistently deliver value to shareholders.

Prudential has been operating in Asia for over 90 years and since 1994 has built high-performing businesses with a product portfolio centred on regular savings and protection, multi-channel distribution, award-winning customer services and a widely recognised brand. Eastspring Investments is a leading asset manager in Asia and provides our clients with access to investment management expertise across a broad range of asset classes.

Although there are common elements such as our focus on regular premium, protection and capital-efficient products, each market in our portfolio has unique characteristics and we adapt our participation strategies accordingly. For example, in Vietnam and Indonesia, life insurance awareness and penetration rates are very low and our priority is building nationwide distribution scale that reaches potential customers and provides them with their first, relatively simple life insurance cover. In Singapore, by contrast, we have more sophisticated financial planners providing advice to customers on a more complex variety of protection, savings and investment options, either directly or via our bank partners.

One of Prudential s core strengths is the diversity of our portfolio by geography, distribution channel and product and the flexibility this gives us in responding to particular opportunities and managing our participation in areas where markets have become more challenging. Consequently, while the headline performance of Prudential Corporation Asia remains relatively stable and predictable over time we are on track to deliver the five-year performance objectives announced in 2013 the individual components are likely to flex period by period. For example, we have recently seen strong demand from Mainland Chinese customers for our participating and critical illness products in Hong Kong, while in Indonesia the emerging middle class is under pressure from systemic challenges in the economy and so demand for our regular-premium, protection-orientated life insurance has been temporarily depressed in that market. We always seek the appropriate balance between value and volume.

#### **Customers**

With more than 14.6 million life customers in Asia, Prudential has one of the largest pan-regional insurance customer bases, with a retention rate of over 90 per cent. To illustrate the scale of our growth and effectiveness of our execution, during 2016 renewal premium collected from our existing customers increased considerably and we paid claims of

nearly £5 billion to our customers.

#### **Products**

Our life product suite has three main categories, participating: linked and protection.

Although the protection component remains relatively consistent in the mix, reflecting our focus on this core customer need, the products within this category continue to evolve. For example, in Hong Kong we recently added a new feature that covers customers in the event of multiple diagnoses of cancer.

For the savings component of our insurance policies, we have seen softer demand for unit-linked products given the recent volatility in capital markets and correspondingly increased demand for participating products and their smoothed returns. The markets do have strong demand for products with high levels of guaranteed return but although these can generate significant sales volumes we only participate in this sector in a very controlled way. We maintain our balance sheet discipline and are unconcerned by any temporary erosion in market share.

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## New Business Premiums

In 2016, total sales of insurance products were £5,948 million, up 25 per cent from 2015 (£4,761 million). Of this amount, regular premium insurance sales increased 31 per cent to £ 3,453 million and single premium insurance sales increased 18 per cent to £ 2,495 million.

The following table shows Prudential s Asian life insurance new business premiums by territory for the periods indicated.

	Actual Exchange Rate*		
	2016 2015		
Single premiums	£m	£m	£m
Hong Kong	1,140	546	419
Indonesia	236	230	280
Malaysia	110	100	117
Philippines	91	146	121
Singapore	523	454	677
Thailand	80	69	92
Vietnam	6	6	4
South East Asia operations including Hong Kong	2,186	1,551	1,710
China (Prudential s 50% interest in joint venture)	124	308	239
Taiwan	36	45	83
India (Prudential s 26% interest in associate)	51	34	28
Total Asia insurance operations excluding Korea	2,397	1,938	2,060
Korea**	98	182	212
Total Asia insurance operations including Korea	2,495	2,120	2,272
Regular premiums	2016 £m	2015 £m	2014 £m
Cambodia	14	8	3
Hong Kong	1,798	1,158	603
Indonesia	255	303	357
Malaysia	233	201	189
Philippines	61	44	39
Singapore	299	264	289
Thailand	81	88	74
Vietnam	115	82	61
South East Asia operations including Hong Kong	2,856	2,148	1,615
China (Prudential s 50% interest in joint venture)	187	111	81
Taiwan	146	127	116
India (Prudential s 26% interest in associates)	170	132	106
Total Asia insurance operations excluding Korea	3,359	2,518	1,918
Korea**	94	123	92
Total Asia insurance operations including Korea	3,453	2,641	2,010
	2017	2015	2014
	2016	2015	2014
	£m	£m	£m

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Total excluding Korea	5,756	4,456	3,978
Korea**	192	305	304
Total including Korea	5,948	4,761	4,282

<sup>\*</sup>Actual Exchange Rate (AER) for translating new business premiums are actual historical exchange rates for the specific accounting period, being the average rates over the accounting period shown.

### **Distribution**

Prudential Corporation Asia is well positioned in terms of our scale and diversity of distribution. Each market is unique and our overarching regional distribution strategy reflects our comprehensive approach to building pan-regional distribution capabilities, underpinned by effective platforms, comprehensive product solutions and the highest level of customer experience.

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<sup>\*\*</sup>The new business premiums from the Group s Korea life subsidiary are shown separately in the table above as it was held for sale at 31 December 2016.

The scale, reach and quality of our life insurance distribution are evidenced by our productivity, persistency and customer satisfaction across the region. At the core of our distribution model is face-to-face interaction with customers, which delivers high-quality, needs-based advice. Supporting this approach is our continuous investment in enhancing customer experiences, such as the PRUcustomer friend customer servicing model in Indonesia and the *PRU for you* online community in Hong Kong.

Tied agency remains the most popular distribution channel in the region. For Prudential Corporation Asia, this produced a significant majority of sales in 2016. At 31 December we had more than 500,000 agents, up 10 per cent on the previous year. Excluding India, the productivity of our active agents increased meaningfully.

Bancassurance is our other main distribution channel, generating a sizable minority of sales for Prudential Corporation Asia in 2016. Prudential Corporation Asia works with a number of partner banks, including international groups such as Standard Chartered Bank, regionals such as UOB, domestic banks such as Thailand s Thanachart Bank and the retail banks of our partners CITIC in China and ICICI in India.

### **Asset management**

Eastspring Investments, Prudential s asset management business in Asia, manages investments for Prudential s Asia, UK and US life companies and also has a broad base of third-party retail and institutional clients.

Our regional asset management division, Eastspring Investments, is one of the region s largest asset managers with a presence in 10 major Asian markets as well as distribution offices in the US and Europe. It has £117.9 billion in assets under management, managing funds across a range of asset classes, including equities and fixed income, distributed through bank partners, brokers and online platforms.

<sup>2</sup> Source: Asia Asset Management September 2016 (Ranked according to participating regional players only). Based on assets sourced from the region, excluding Japan, Australia and New Zealand as at June 2016 Eastspring has a stable and steadily growing core of funds under management from Prudential Corporation Asia s life businesses, including the majority of its unit-linked funds. Its Asian focus and performance track record have also enabled it to secure sizeable institutional mandates, both in Asia and more broadly. The retail arm includes the attractive Japanese, Korean and Taiwanese markets. In Japan, our Asia Oceania High Dividend Equity Fund, with funds under management of £3.2 billion, is one of the largest in its sector.

The following table shows funds managed by Eastspring Investments at the dates indicated.

	At 31 I	At 31 December £bn		
	2016	2015	2014	
Internal fund management	72.2	52.8	47.2	
External fund management	45.7	36.3	30.1	
Total	117.9	89.1	77.3	

#### **Investing for growth**

Prudential s platform is well established and we continue to invest in growing the business through expansion into new markets such as Laos and opening up in new cities in existing markets such as China, Indonesia and the Philippines.

We are also investing in expanding our agency network in the region and we are enhancing our operating capabilities, particularly leveraging new technologies.

At Eastspring we are investing in the brand, in the operating model and in talent development, in order to ensure that we expand our regional capabilities to capture the opportunities available from the growth of the retail mutual funds markets in Asia.

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### **United States**

#### Introduction

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

As at 31 December 2016, in the United States, Jackson:

was the 15th largest life insurance company in terms of general account assets<sup>(1)</sup>; had £120 billion of separate account assets, 3 times higher since 2010; and has been recognised for customer service performance with the Contact Center World Class FCR Certification and Highest Customer Service for the Financial Industry awards by The Service Quality Measurement Group, Inc. for the 10th consecutive year.

### (1) Source: Fourth Quarter 2016 SNL Financial

The US operations also include PPM Holdings, Inc. ( PPM ), Prudential s US internal and institutional investment management operation, and National Planning Holdings, Inc. ( NPH ), Prudential s US affiliated independent broker dealer network. As at 31 December 2016, Prudential s US operations had more than 4 million policies and contracts in force and PPM managed approximately £87.6 billion of assets. In 2016, new business premiums totalled £15,608 million.

## Market overview

The US is the world s largest retirement savings market currently worth a total of US\$16 trillion and approximately 40 million Americans will reach retirement age over the next decade alone. This transition will trigger the need for an unprecedented shift of trillions of dollars from savings accumulation to retirement income generation.

However, these Americans face unique challenges in planning for life after work. For many members of this generation, a financially secure retirement is at risk due to insufficient accumulation of savings during their working years and the current combination of low yields and market volatility. Employer-based pensions are disappearing and government plans are underfunded. Social security was never intended to be a primary retirement solution and today, its long-term funding status is in question. Additionally, the life expectancy of an average retiree has significantly increased, lengthening the number of years for which retirement funding is required.

To overcome these challenges, Americans need retirement strategies that offer them the opportunity to grow and protect the value of their existing assets, as well as the ability to provide guaranteed income that will last throughout their extended lifetimes. Annuities can do just that.

Through its distribution partners, Jackson provides products, including variable, fixed and fixed index annuities, which offer Americans the strategies they need. A variable annuity with investment freedom represents an attractive option for retirees, providing both access to equity market appreciation in a tax-deferred wrapper and guaranteed lifetime income. However, penetration of variable annuity sales into the retirement market remains low, accounting for less than 15 per cent of total US retirement assets.

## **Customers and products**

Jackson develops and distributes products that address the retirement needs of our customers through various market cycles. These products include variable annuities, fixed annuities and fixed index annuities.

Jackson has a proven track record in this market with its market-leading flagship variable annuity product, Perspective. Jackson s success has been built on its quick-to-market product innovation, as demonstrated by the

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development and launch of Elite Access, our first investment-only variable annuity, in 2012. By the first quarter of 2013, sales of Elite Access ranked in the top<sup>3</sup> 10 of all variable annuity contract sales in the US, a position it still holds<sup>3</sup>. Further demonstrating Jackson s flexibility and manufacturing capabilities, in the past six months Jackson has launched Perspective Advisory and Elite Access Advisory to serve distributors with a preference for fee-based products.

## Additional information on products

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

	Actual Exchange Rate		
	Year Ended 31 December £m		
	2016	2015	2014
By Product			
Annuities			
Fixed annuities			
Fixed interest rate	533	462	512
Fixed index	508	458	370
Immediate	22	15	15
Variable annuities	10,653	11,977	10,899
Elite Access (Variable annuities)	2,056	3,144	3,108
Total	13,772	16,056	14,904
Institutional products			
GICs, funding agreements and Federal Home Loan Bank of			
Indianapolis (FHLBI) funding agreements	1,836	1,230	651
Total	15,608	17,286	15,555
By Distribution Channel			
Independent broker dealer	8,809	10,145	9,521
Bank	2,137	2,730	2,394
Regional broker dealer	2,199	2,634	2,477
Independent insurance agents	627	547	512
Institutional products	1,836	1,230	651
Total	15,608	17,286	15,555

Of the total new business premiums of £15,608 million in 2016 (2015: £17,286 million; 2014: £15,555 million), £13,772 million (2015: £16,056 million; 2014: £14,904 million) were single premiums, and £1,836 million (2015: £1,230 million; 2014: £651 million) were institutional product premiums. There were no regular premiums.

#### Annuities

#### **Fixed Annuities**

### Fixed Interest Rate Annuities

In 2016, fixed interest rate annuities accounted for 3 per cent (2015: 3 per cent) of total new business premiums and 8 per cent (2015: 9 per cent) of policy and contract liabilities of the US operations. Fixed interest rate annuities are primarily deferred annuity products that are used for asset accumulation in retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The contract holder of a fixed interest rate annuity pays Jackson a premium, which is credited to the contract holder s account. Periodically, interest is credited to the contract holder s account and in some cases administrative charges are deducted from the contract holder s account. Jackson makes benefit payments at a future date as specified in the contract based on the value of the contract holder s account at that date.

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On more than 94 per cent (2015: 93 per cent) of in-force business, Jackson may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, Jackson either pays the contract holder the amount in the contract holder account or begins making payments to the contract holder in the form of an immediate annuity product. This latter product is similar to a UK annuity in payment.

At 31 December 2016, Jackson had fixed interest rate annuities totalling £14.2 billion (US\$17.6 billion) (2015: £12.1 billion (US\$17.8 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 5.5 per cent and a 2.96 per cent average guaranteed rate (2015: 1.0 per cent to 5.5 per cent and a 3.00 per cent average guaranteed rate).

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

Approximately 62 per cent (2015: 62 per cent) of the fixed interest rate annuities Jackson wrote in 2016 provide for a market value adjustment that could be positive or negative on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment. While the MVA feature minimizes the surrender risk associated with certain fixed interest rate annuities, Jackson still bears a portion of the surrender risk on policies without this feature, and the investment risk on all fixed interest rate annuities.

### Fixed Index Annuities

Fixed index annuities accounted for 3 per cent (2015: 3 per cent) of total new business premiums in 2016 and 6 per cent (2015: 6 per cent) of Jackson s policy and contract liabilities. Fixed index annuities vary in structure, but generally are deferred annuities that enable the contract holder to obtain a portion of an equity-linked return (based on participation rates and caps) and provide a guaranteed minimum return. These guaranteed minimum rates are generally set at 1.0 per cent to 3.0 per cent on index funds. At 31 December 2016, Jackson had fixed index annuities allocated to index funds totalling £7.3 billion (US\$9.0 billion) (2015: £6.4 billion (US\$9.5 billion)) in account value with minimum guaranteed rates on index accounts ranging from 1.0 per cent to 3.0 per cent and a 1.77 per cent average guaranteed rate (2015: 1.0 per cent to 3.0 per cent and a 1.79 per cent average guaranteed rate). Jackson also offers fixed interest accounts on some fixed index annuity products. At 31 December 2016, fixed interest accounts on fixed index annuities totalled £2.6 billion (US\$3.2 billion) (2015: £1.9 billion (US\$2.8 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 2.55 per cent average guaranteed rate (2015: 1.0 per cent to 3.0 per cent average guaranteed rate).

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

Jackson hedges the equity return risk on fixed index products using offsetting equity exposure in the variable annuity product. The cost of these hedges is taken into account in setting the index participation rates or caps. Jackson bears

the investment risk and a portion of the surrender risk on these products.

## **Immediate Annuities**

In 2016, immediate annuities accounted for less than one per cent (2015: less than one per cent) of total new business premiums and one per cent (2015: one per cent) of Jackson s policy and contract liabilities. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed

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period of years and/or the life of the contract holder. If the term is for the life of the contract holder, then Jackson s primary risks are mortality and reinvestment. This product is generally used to provide a guaranteed amount of income for contract holders and is used both in planning for retirement and in retirement itself. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

#### Variable Annuities

In 2016, variable annuities accounted for 81 per cent (2015: 87 per cent) of total new business premiums and 74 per cent (2015: 70 per cent) of Jackson s policy and contract liabilities. Variable annuities are deferred annuities that have the same tax advantages and payout options as fixed interest rate and fixed index annuities. They are also used for asset accumulation in retirement planning and to provide income in retirement.

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

At 31 December 2016, Jackson had variable annuity funds in fixed accounts totalling £7.3 billion (US\$9.0 billion) (2015: £5.5 billion (US\$8.1 billion)) with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 1.64 per cent average guaranteed rate (2015: 1.0 per cent to 3.0 per cent and a 1.70 per cent average guaranteed rate).

Jackson offers a choice of guaranteed benefit options within its variable annuity product portfolio, which customers can elect for additional fees. These guaranteed benefits might be expressed as the return of either a) total deposits made to the contract adjusted for any partial withdrawals, b) total deposits made to the contract adjusted for any partial withdrawals, plus a minimum return, or c) the highest contract value on a specified anniversary date adjusted for any withdrawals following that contract anniversary. These options include the guaranteed minimum death benefits (GMDB), which guarantee that, upon death of the owner, the beneficiary receives at least the minimum value regardless of past market performance. In addition, there are three other types of guarantees: guaranteed minimum withdrawal benefits (GMWB), guaranteed minimum accumulation benefits (GMAB) and guaranteed minimum income benefits (GMIB). GMWBs provide a guaranteed return of the minimum value by allowing for periodic withdrawals that are limited to a maximum percentage of the initial premium. One version of the GMWBs provides for a minimum annual withdrawal amount that is guaranteed for the contract holder s life without annuitisation. GMABs generally provide a guarantee for a return of the defined minimum value after a specified period. Jackson no longer offers GMABs. GMIBs provide for a minimum level of benefits upon annuitisation regardless of the value of the investments underlying the contract at the time of annuitisation. Jackson no longer offers GMIBs, with existing coverage being substantially reinsured with an unaffiliated reinsurer.

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

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

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## Aggregate distribution of account values

The table below shows the distribution of account values for fixed annuities (fixed interest rate and fixed index) and variable annuities fixed options within the range of minimum guaranteed interest rates as described above as at 31 December 2016 and 2015:

	Accoun	Account value £m	
Minimum guaranteed interest rates - annuities	2016	2015	
1.0%	7,765	5,563	
> 1.0% - 2.0%	8,718	7,670	
> 2.0% - 3.0%	11,249	9,586	
> 3.0% - 4.0%	1,456	1,263	
> 4.0% - 5.0%	1,954	1,639	
> 5.0% - 5.5%	247	212	
Total	31,389	25,933	

### Life Insurance

#### **Background**

Jackson discontinued new sales of life insurance products in 2012. The discontinued Jackson s life insurance products accounted for 10 per cent (2015: 11 per cent) of Jackson s policy and contract liabilities in 2016. Life products include term life and interest sensitive life (universal life and variable universal life.) Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a type of life insurance policy that combines death benefit protection with the ability for the contract holder account to be invested in separate account funds. Jackson s life insurance book has delivered consistent profitability, driven primarily by positive mortality and persistency experience. For certain fixed universal life plans, additional provisions are held to reflect the existence of guarantees offered in the past that are no longer supported by earnings on the existing asset portfolio, or for situations where future mortality charges are not expected to be sufficient to provide for future mortality costs.

#### Aggregate distribution of account values

Excluding the business formerly of the REALIC operations acquired in 2012 that is subject to the retrocession treaties, at 31 December 2016, Jackson had interest-sensitive life business in force with total account value of £7.1 billion (US\$8.8 billion) (2015: £6.1 billion (US\$9.0 billion)), with minimum guaranteed interest rates ranging from 2.5 per cent to 6.0 per cent with a 4.66 per cent average guaranteed rate (2015: 2.5 per cent to 6.0 per cent with a 4.66 per cent average guaranteed rate). The table below shows the distribution of the interest-sensitive life business account values within this range of minimum guaranteed interest rates as at 31 December 2016 and 2015:

	Account v	Account value £m	
Minimum guaranteed interest rates	2016	2015	
> 2.0% - 3.0%	243	204	
> 3.0% - 4.0%	2,675	2,322	

> 4.0% - 5.0%	2,333	2,023
> 5.0% - 6.0%	1,839	1,574
Total	7,090	6,123

### **Institutional Products**

Institutional products consist of traditional guaranteed investment contracts (GICs), funding agreements (including agreements issued in conjunction with Jackson s participation in the US Federal Home Loan Bank of Indianapolis (FHLBI) programme) and Medium-Term Note funding agreements. In 2016, institutional products accounted for 12 per cent (2015: 7 per cent) of total new business premiums and 1 per cent (2015: 3 per cent) of Jackson s policy and contract liabilities. The GICs are marketed by Jackson s institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its programme. Jackson makes its profit on the spread between the yield on its investments and the interest rate credited to contract holders.

## Traditional Guaranteed Investment Contracts

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

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

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

#### Funding Agreements

Under a funding agreement, the contract holder either makes a lump sum deposit or makes specified periodic deposits. Jackson agrees to pay a rate of interest, which may be fixed or a floating short-term interest rate linked to an external index. Interest is paid quarterly to the contract holder. The duration of the funding agreements range between one and thirty years. At the end of the specified term, contract holders may re-deposit the principal in another funding agreement.

Typically, brokerage accounts and money market mutual funds are required to invest a portion of their funds in cash or cash equivalents to ensure sufficient liquidity to meet their customers—requirements. The funding agreements permit termination by the contract holder on seven to 90 days notice, and thus qualify as cash equivalents for the clients purposes. In 2016 and 2015, there were no funding agreements terminable by the contract holder with less than 90 days notice.

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

### Medium Term Note Funding Agreements

Jackson has also established European and global medium-term note programmes. The notes offered may be denominated in any currency with a fixed or floating interest rate. Notes are issued to institutional investors by a special purpose vehicle and are secured by funding agreements issued by Jackson.

#### Distribution

Jackson distributes products in all 50 states of the United States and in the District of Columbia, although not all products are available in all states. Operations in the state of New York are conducted through a New York insurance subsidiary. Jackson markets its retail products primarily through advice based distribution channels, including independent agents, independent broker-dealer firms, regional broker-dealers, wirehouses, and banks.

Jackson s distribution strength also sets us apart from our competitors. Our wholesaling force is the largestin the variable annuity industry and is instrumental in supporting the independent advisers who help the growing pool of American retirees develop effective retirement strategies. Our wholesalers provide extensive training to thousands of advisers about the range of our products and the investment strategies that are available to support their clients. Based on the latest available data, Jackson s wholesalers achieved gross variable annuity sales that on average were

meaningfully higher than the nearest competitor<sup>4</sup>.

### **Independent Agents and Broker Dealers**

National Planning Holdings (NPH), an affiliate of Jackson, is a top 10 broker dealeretwork in the US. NPH serves the three key distribution channels of independent representatives, financial institutions and tax and accounting professionals, through access to industry-leading mutual fund/asset management companies, insurance carriers and thousands of brokerage products. The strength of this network and the market insight it offers, combined with Jackson s proven manufacturing capabilities, provide a distinct advantage as we continue to navigate the ever-changing regulatory landscape.

### **Regional Broker Dealers**

Jackson's Regional Broker Dealer (RBD) team provides dedicated service and support to regional brokerage firms and wirehouses. Regional broker dealers are a hybrid between independent broker dealers and wirehouses.

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Like representatives who work for wirehouses, financial representatives at regional broker dealers are employees of the firm. However, unlike wirehouses, RBD firms have limited institutional investment banking services. The RBD team develops relationships with regional firms throughout the US and provides customised materials and support to meet their specialised advisory needs.

Jackson s RBD team supports more than 40,600 representatives in regional broker dealers and wirehouses.

### Banks, Credit Unions and Other Financial Institutions

Jackson s Institutional Marketing Group distributes annuity products through banks, credit unions and other financial institutions and through third party marketing organisations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and at 31 December 2016 had access to more than 33,000 financial institution representatives through existing relationships with banks and credit unions. Jackson has established distribution relationships with medium sized regional banks, which it believes are unlikely to develop their own insurance product capability.

### **Independent Broker Dealers**

Jackson s retail distribution is managed by Prudential s independent broker dealer network, NPH, which is described in more detail above. NPH had more than 3,300 registered representatives at the end of 2016.

#### **Institutional Products Department**

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

#### **PPM**

PPM is Prudential s US institutional investment management operation, with its primary office in Chicago. PPM manages assets for Prudential s US, UK and Asian affiliates. PPM provides affiliated and unaffiliated institutional clients with investment services including managing assets for separate accounts, US mutual funds and similar foreign pooled investment vehicles, a collateralised loan obligation and private equity funds. PPM s strategy is focused on managing existing assets effectively, maximising the benefits derived from synergies with our international asset management affiliates, and leveraging investment management capabilities across the Group. PPM also pursues third-party mandates on an opportunistic basis.

### Regulatory landscape

Since the financial crisis in 2008, the industry has continued to manage through an ever-changing regulatory landscape. In April 2016, the US Department of Labor (DoL) released a final version of its Fiduciary Duty Rule (Rules), with initial application starting in April 2017 and full implementation required by January 2018. The Rules would, as currently written, subject many advisers who work with qualified retirement plans and Individual Retirement Accounts to the fiduciary requirements of the Employee Retirement Income Security Act including obligations to avoid conflicts of interest. Those conflict of interest rules are incompatible with many compensation structures that have historically been permissible. However, with the change in the US administration and the release of various Executive Orders, the final form of the Rules remains unclear.

As a result of the DoL regulatory initiative and the uncertainties regarding the application and implementation of the Rules, the annuity industry saw material impacts on sales in 2016. Sales in the variable annuity industry as of the third quarter of 2016 were down significantly compared with the same period last year. Conversely, sales of fixed index and fixed annuity products were higher<sup>6</sup> as of the third quarter of 2016 compared with the same period last year. In recent years, some competitors have begun to offer fixed index annuities with benefits that resemble those of variable annuities, leading to a shift in sales away from variable annuities to fixed index annuities. However, this trend has an uncertain future due to the unexpected inclusion of fixed index annuities within the current rules on par with the treatment of variable annuities. Total annuity industry sales were down slightly as of the third quarter of 2016<sup>6</sup>.

Regardless of the outcome of the Rules, the regulatory disruption has challenged the industry to review the ways in which investment advice is provided to American investors. Manufacturers will need to have the ability to provide product and system adaptions in order to support the success of various distribution partners in their delivery of invaluable retirement strategies that investors need.

## Investment for growth

From disruption, opportunities can appear. With the tens of trillions of dollars of adviser-distributed assets across distribution platforms that have not historically been a focus, such as the hybrid registered investment adviser channel, there is significant opportunity to reach even more American retirees and serve their needs with annuity products going forward. The industry will need to remain flexible and cost-effective in making changes to products, systems and processes. We continue to ensure that we understand and make the necessary adjustments to support the needs and demands of American retirees into the future.

Jackson and NPH have begun to implement changes necessary to meet the requirements of the Rules. Jackson will continue to evaluate its product offerings in order to meet the long-term needs of investors in search of effective retirement strategies. Additionally, Jackson remains committed to supporting its distribution partners throughout this industry transition.

Jackson s competitive strengths are even more critical during periods of disruption. Our best-in-class distribution team, our agility and success in launching well designed products, the continued success through many economic cycles of our risk management and hedging programmes and our effective technology platforms and award-winning customer service will provide Americans with the retirement strategies they so desperately need, and will enable us to be positioned to capture additional growth during times of transition and into the future.

## Disciplined risk management

Jackson operates within a well-defined risk framework aligned with the overall Prudential Group risk appetite. The type and number of products we sell remains balanced. Our disciplined economic approach to pricing is designed to achieve both adequate returns on our products and sufficient resources to support our hedging programme.

Jackson s hedging or 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, as explained further in note C7.3 to the consolidated financial statements. Our hedge philosophy has not changed in 2016. Jackson is able to aggregate financial risks across the company, obtain a unified view of our risk positions, and actively manage net risks through an economically-based hedging programme. A key element of our core strategy is to protect the company from severe economic scenarios while maintaining adequate regulatory capital. We benefit from the fact that the competitive environment continues to favour companies with robust financial strength and a demonstrated track record of financial discipline, both key elements of our long-term strategy.

In general, Jackson s results are affected by fluctuations in economic and market conditions, especially interest rates, credit conditions and equity markets. The profitability of Jackson s spread based business depends largely on its ability to manage interest rate exposure, as well as the credit and other risks inherent in its investment portfolio. Jackson designs its products and manages the investments and liabilities to reduce overall interest rate sensitivity. This has the effect of moderating the impact on Prudential s results from changes in prevailing interest rates.

Jackson s exposure to interest rate risk relates primarily to the market price and cash flow variability associated with changes in interest rates. Changes in interest rates, either upward or downward, including changes in the difference between the levels of prevailing short-term and long-term rates, can expose Jackson to the risk of not earning anticipated spreads. For example, if interest rates increase and/or competitors offer higher crediting rates, withdrawals on annuity contracts may increase as contract holders seek higher investment returns elsewhere. In response, Jackson could (i) raise its crediting rates to stem withdrawals, decreasing its spread; (ii) sell assets which may have depressed values in a high interest rate environment to fund policyholder payments, creating realised investment losses; or

(iii) pay out from existing cash which would otherwise have been invested and earned interest at the higher interest rates.

Conversely, if interest rates decrease, withdrawals from annuity contracts may decrease relative to original expectations, creating more cash than expected to be invested at lower rates. Jackson may have the ability to lower the rates it credits to contract holders as a result, but may be forced to maintain crediting rates for competitive reasons or because there are minimum interest rate guarantees in certain contracts. In either case, the spread earned by Jackson would be compressed.

The majority of assets backing the spread-based business are invested in fixed income securities. Jackson actively manages its investment and derivative portfolio, considering a variety of factors, including the relationship between the expected duration of its assets and its liabilities.

Recent periods have been characterised by low interest rates. The current low interest rate environment is likely to be prolonged. A prolonged low interest rate environment may result in a lengthening of maturities of the contract holder liabilities from initial estimates, primarily due to lower policy lapses. As interest rates remain at low levels, Jackson may also have to reinvest the cash it receives as interest or proceeds from investments that have matured or that have been sold at lower yields, reducing its investment margins. Moreover, borrowers may prepay or redeem the securities in its investment portfolio with greater frequency in order to borrow at lower market rates, which exacerbates this risk.

The majority of Jackson's fixed interest rate annuities and life products were designed with contractual provisions that allow crediting rates to be re-set annually subject to minimum crediting rate guarantees. Therefore, on new business written, as well as on in-force business above minimum guarantees, Jackson has adjusted, and will continue to adjust, crediting rates in order to maintain targeted interest rate spreads.

Lowering crediting rates helps to mitigate the effect of spread compression but the spreads could still decline as Jackson is typically only entitled to reset the crediting rates at limited pre-established intervals and the re-setting is subject to the guaranteed minimum rates. As at 31 December 2016, approximately 86 per cent of Jackson s fixed interest rate annuities and interest-sensitive life business account values correspond to crediting rates that are at the minimum guaranteed interest rates (2015: 87 per cent). Tabular disclosures are provided above on the distribution of the account values of these businesses within the range of their contractual minimum guaranteed interest rates. The tables demonstrate that approximately 73 per cent (2015: 72 per cent) of Jackson s combined fixed interest rate annuities and interest sensitive life business account values of £28 billion (2015: £23 billion) have contractual minimum rates of 3 per cent or less.

Jackson s expectation for future spreads is also an important component in the amortisation of deferred acquisition costs. Significantly lower spreads may cause it to accelerate amortisation, thereby reducing total IFRS profit in the affected reporting period. Low market interest rates could also reduce Jackson s return on investments that are held to support the company s capital. In addition, changes in interest rates will affect the net unrealised gain or loss position of Jackson s available-for-sale fixed income securities which is reported as a component of other comprehensive income. Further information on the factors affecting the pricing of products and asset liability management of Jackson is provided below.

In addition to the impact on Jackson's spread product profitability, a prolonged period during which interest rates remain at levels lower than those anticipated in its pricing may result in greater costs associated with certain of Jackson's product features which guarantee benefits, and also result in higher costs for derivative instruments used to hedge certain of its product risks. Reflecting these impacts in recoverability and loss recognition testing under US GAAP as grandfathered under IFRS may require Jackson to accelerate the amortisation of DAC as noted above, as well as to increase required reserves for future contract holder benefits. In addition, certain statutory capital and reserve requirements are based on formulas or models that consider interest rates, and a prolonged period of low interest rates may increase the statutory reserves and capital Jackson is required to hold.

Accordingly, without active management, a prolonged low interest rate environment may materially affect Jackson s financial position, results of operations and cash flows. However, Jackson has and continues to adapt proactively its asset-liability management, hedging programme, product design and pricing and crediting rate strategies to mitigate the downward pressures created by the prolonged low interest rate environment.

The sensitivity of Jackson s IFRS basis profit or loss and shareholders equity to changes in interest rates is provided in note C7.3 to the consolidated financial statements.

The profitability of Jackson s fee-based business depends largely on its ability to manage equity market risk. As the investment return on the separate account assets is attributed directly to the contract holders, Jackson s profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of guarantees. In addition to being a profitable book of business, the variable annuity book also provides an opportunity to utilise

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the offsetting equity risk among various lines of business to effectively manage Jackson s equity exposure. Jackson believes that the internal management of equity risk, coupled with the utilisation of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure. Profits in the variable annuity book of business will continue to be subject to the impact of market movements both on sales and allocations to the variable accounts and the effects of the economic hedging program. While Jackson hedges its risk on an economic basis, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility.

Jackson continues to believe that, on a long-term economic basis, its equity exposure remains well managed.

### Factors Affecting Pricing of Products and Asset Liability Management

Jackson prices products based on a variety of assumptions including, but not limited to, mortality, investment yields, expenses and contract holder behaviour. Pricing is influenced by Jackson s objectives for return on capital and by competition. Although Jackson includes a profit margin in the price of its products, the variation between the assumptions and actual experience can result in the products being more or less profitable than originally assumed. This variation can be significant.

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

Jackson segregates its investment portfolio for certain investment management purposes, and as part of its overall investment strategy, into four portfolios: life and fixed annuities without market value adjustment, fixed annuities with market value adjustment, fixed index annuities and institutional liabilities. The portfolios backing life and fixed annuities with and without market value adjustments and the fixed index annuities have similar characteristics and differ primarily in duration. The portfolio backing the institutional liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the institutional portfolio is managed to permit less interest rate sensitivity and has limited exposure to mortgage backed securities. At 31 December 2016, one per cent of the institutional portfolio was invested in residential mortgage backed securities.

The fixed-rate products may incorporate surrender charges, market value adjustments, two-tiered interest rate structures or other limitations relating to when policies can be surrendered for cash, in order to encourage persistency. As of 31 December 2016, 57 per cent of Jackson s fixed annuity reserves had surrender penalties or other withdrawal restrictions. Substantially all of the institutional portfolio had withdrawal restrictions or market value adjustment provisions.

Fixed index annuities issued by Jackson also include an equity component that is hedged using the offsetting equity exposure in the variable annuity product. The equity component of these annuities constitutes an embedded derivative that is carried at fair value, as are other derivative instruments.

Guaranteed benefits issued by Jackson in connection with the sales of variable annuity contracts expose Jackson to equity risk as the benefits generally become payable when equity markets decline and contract values fall below the guaranteed amount. As discussed previously, the liability for certain of these benefits is carried at fair value with changes in fair value recorded in income. Jackson manages the exposure of the tail risk associated with the equity exposure using equity options and futures contracts, which are also carried at fair value. Jackson seeks to manage the

economic risk associated with these contracts and, therefore, has not explicitly hedged its fair value risk as determined for IAS 39. In addition, certain benefits have mortality risk and are therefore precluded from being carried at fair value. As a result of these factors, the income statement may include a timing mismatch related to changes in fair value. However, as demonstrated during the economic crisis, subsequent rebound and recent volatility in the equity markets, Jackson s hedges have effectively operated as designed.

- <sup>2</sup> Cerulli Associates Advisor Metrics 2016
- <sup>3</sup> ©2017 Morningstar Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. Morningstar <a href="www.AnnuityIntel.com">www.AnnuityIntel.com</a>. Total VA Sales by contract 1Q 2013. Elite Access for base states ranked #10 and #9 for Total VA Sales by Contract at 1Q 2013 and 3Q 2016 respectively.
- <sup>4</sup> Market Metrics Variable Annuity Sales, Staffing and Productivity Report: Q3 2016.
- <sup>5</sup> Investment News April 2016
- <sup>6</sup> LIMRA/Secure Retirement Institute, US Individual Annuity Participants Report 3Q YTD 2016

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### **United Kingdom Insurance and Investments**

#### Introduction

In the United Kingdom, Prudential UK & Europe (UK&E) provides insurance and investment products offering a range of retail financial products and services, including long-term insurance and asset accumulation and retirement income products (life insurance, pensions and pension annuities), retail investment and unit trust products. Prudential in the United Kingdom primarily distributes these products through financial advisers, partnership agreements with other financial institutions, and direct marketing, by telephone, mail, internet and face-to-face advisers.

As at 31 December 2016, Prudential UK & Europe:

was one of the market leaders in the retirement income and the with-profits market<sup>(1)</sup> and had total company assets of £195 billion on the balance sheet, comprising £126 billion within the with-profits sub-funds (including the Scottish Amicable Insurance Fund, which is a closed fund formed following the acquisition of the mutual Scottish Amicable Life Assurance Society in 1997) and £69 billion held by its shareholder-backed business.

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

#### Market overview

The fundamentals underpinning the UK s retirement market are changing. Risk and responsibility for retirement provision continue to transfer away from the state and corporates to individuals. As customers adjust to the reforms introduced by pensions freedoms in 2015, the new flexible arrangements to control their own pensions have been accompanied by significant complexity, which is adding to the burden of personal responsibility to secure an income in retirement. Investment risk, longevity risk and inflation risk are the risks to be mitigated by today s retirement saver.

Over 70 per cent of liquid assets in the UK are owned and controlled by the over 50s and this demographic is expected to grow by 2.1 million between 2016 and 2030. More people, with more savings, will live longer. This provides significant new opportunities for Prudential as the demand for risk-managed investments to fund retirement is predicted to rise accordingly.

To meet these opportunities, our product and distribution profile has evolved by increasing the range of product options to mirror the flexibilities of the pensions freedom era. There has been a shift away from a reliance on capital-intensive annuity business to a focus on bond, ISA, pension and income drawdown products across a range of tax-efficient solutions.

## **Customers and products**

The Prudential brand benefits from a heritage that stretches back 168 years and a franchise that is based on long-term thinking, longevity experience, market-leading multi-asset investment capability and financial strength the core attributes that customers continue to seek in the pension freedoms era.

Customer expectations are higher than ever. Increased life expectancy in retirement has put increased demands on long-term product performance, and technology is revolutionising the ways in which company and customer interact.

In this changing environment, our brand franchise is strong, resonating with retirement savers.

We continue to focus on meeting these customers needs through:

- a. Extending our product range and servicing capability to help customers take full advantage of the flexibility introduced to the retirement saving marketplace through pension freedoms;
- b. Extending availability of our investment and retirement solutions by maintaining strong relationships with financial adviser intermediaries, accelerating the growth of our Prudential Financial Planning advisory business and through investing in our direct-to-consumer channels, including telephone and online services;

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- c. Enhancing access to our market-leading PruFund proposition across a range of investment and tax wrappers; and
- d. Continually investing in customer service improvement, acknowledged by two Five Star ratings received for the sixth consecutive year in the Life & Pensions and Investment categories of the Financial Adviser Service Awards.

Most notably in 2016, we responded to changes in the market following the introduction of pension freedoms by launching the Prudential Retirement Account — an online account-based plan that provides customers with the flexibility to save for their retirement, provide an income in retirement and facilitate access to their fund as they save. At its core is PruFund, our customer proposition managed by the Prudential Portfolio Management Group, our award-winning and market-leading multi-asset management team. From a single fund when launched in 2004, PruFund today comprises six risk-rated funds, offers global investment diversification across 25 different asset classes and delivers smoothing through the strength of the Prudential with profits Fund.

The success of PruFund and its popularity among financial advisers and customers is evidenced in investments worth £24.7 billion in funds under management at the end of 2016.

In corporate pensions, we continue to focus on securing new scheme members and supporting existing members to meet their retirement goals. In the public sector, where Prudential is the market leader, providing schemes for 74 of the 99 local authorities in the UK, our focus is on additional voluntary contribution plans.

Having identified a number of alternative capital deployment opportunities within the Group and following the introduction of Solvency II we did not write any bulk annuity business in 2016. We have now withdrawn from this market. Our appetite for individual annuity business has also diminished and we took steps to curtail retail sales by establishing an annuity panel arrangement with a number of firms to provide annuities to our retiring customers. This new service will be phased in over the course of 2017.

### **Distribution**

The foundations of every strong brand are trust and confidence, common denominators in Prudential s multi-channel distribution capability. The model is centred on the core intermediary channel and direct-to-consumer channels, including Prudential Financial Planning.

At the heart of the Intermediary model is the power of three, a combination of regional account manager, telephone account manager and sales support, all working together as a regional sales unit team. There are 65 regional sales units across the UK, giving 100 per cent nation-wide coverage and each having account managers qualified to at least the same standards as the professional advisers they deal with. This model gives third-party financial advisers the support they need, how and when they need it, through dedicated points of contact either in the field or by phone. This approach delivered an 11 per cent compound increase since 2013 in advisory firms recommending Prudential products to their clients. Sales through our intermediary business have also doubled since 2013.

Prudential Financial Planning reinforces Prudential s industry reputation as an innovator and has been central to the continued sales growth achieved by the business in 2016. From its inception in 2012, and against a background of industry-wide retrenchment, Prudential Financial Planning is now a top 10 UK advisory business, with close to 300 partners advising more than 50,000 clients.

Our direct-to-consumer customer telephony team is central to our ambitions to grow our Direct to Customers business and in 2016 we strengthened its capability ahead of a range of forthcoming proposition and service developments.

The roll-out of our business in Poland continued in 2016, with sales increasing significantly in local currency terms. Significant milestones during the year included increasing the number of financial planning consultants to 721, entering the multi-agency market and securing three affinity distribution deals with Polish telecommunications companies.

### **Investment for growth**

We are focused on maintaining the growth momentum created by the structural changes to retirement provision in the UK and on delivering a growth strategy underpinned by investment in product, service and distribution capabilities to meet the evolving needs of customers.

In addition to enhancing access to our market-leading PruFund proposition, we continue to innovate by bringing new and exciting products to the market, such as the Prudential Retirement Account, for our customers who want to use the pensions freedom provisions to their fullest.

Investment in technology is also enabling customers to engage more flexibly with us digitally and online. Easier access to product information for customers is provided by the My Pru App, while our Retirement Ready Guide App was created to provide clear and easy-to-understand information for those coming up to retirement. Technology has also helped us improve online services for advisers and enhance our tele-underwriting service for the Prudential Investment Plan, reducing the amount of time advisers spend on administration and freeing up time to spend with their clients.

We have also focused on deepening our already-strong relationships with independent financial advisers. An important part of our service offering is the ongoing hands-on support for intermediary advisers from our regional sales units, technical helpline and business development and consultancy team. Our adviser webinars attracted more than 10,000 attendees in 2016 while we also hosted 58 adviser seminars across the UK, covering a range of topical and technical subjects, to help these advisers deal with a changing regulatory landscape.

We will also accelerate the growth of Prudential Financial Planning, which currently has close to 300 advisers delivering face-to-face advice in customers homes and has introduced a telephone advice service to reflect the additional ways in which customers want to receive financial advice.

The evolving nature of how we interact with customers is also driving our ambitions to grow our direct-to-consumer business, where we have strengthened our capability ahead of a range of forthcoming developments, including launch of a direct-to-consumer ISA.

#### **Additional information on products**

In 2014-2016, Prudential UK&E s new business premiums by channel are as follows:

	Year Ended 31 December £m		
	2016	2015	2014
Individual Annuities:			
Direct & Partnerships	93	107	162
Intermediated	35	62	139
Internal Vesting *	418	396	764
Total Individual Annuities	546	565	1,065
Other Products:			
Direct & Partnerships	1,257	980	702
Intermediated	8,210	5,589	3,370
Wholesale	-	1,508	1,710

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Total Other Products	9,467	8,077	5,782
Total New Business Premiums (excluding PruHealth			
and PruProtect businesses)	10,013	8,642	6,847
PruHealth and PruProtect businesses**	-	-	23
Total New Business Premiums	10,013	8,642	6,870

<sup>\*</sup>Internal vesting business is classified as new business where the contracts include an open market option.

<sup>\*\*</sup>Following the disposal of Prudential UK&E s 25 per cent interest in PruProtect and PruHealth in November 2014, the 2014 comparatives have been adjusted to show the premiums of those businesses separately.

## **Direct and Partnerships**

Direct distribution channels include the telephone, mail and internet, and focus on annuities, investments and pension products. Prudential UK&E s direct advice service, Prudential Financial Planning (PFP), focuses primarily on the financial planning needs of our existing direct customer base. At the end of 2016, its fifth year of trading, sales grew strongly compared with 2015, adviser partner numbers had reached 290, assets under advice were circa £3.8bn and households under advice were circa 55,000.

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

### **Intermediaries**

Strong growth in sales through our intermediary channel reflected the strength of our PruFund proposition and our relationships with key intermediary firms. Increased sales of with-profits bonds, PruFund ISA, individual pensions and income drawdown outweighed the impact of the slow-down in the annuities market. With-profits bond sales through intermediaries grew at a favourable rate in 2016, largely due to our PruFund bond proposition, where our track record of investment performance differentiates us from our competitors. PruFund ISA grew very strongly, as did, individual pensions, and to a lesser extent, income drawdown, with the overwhelming majority of pensions and drawdown investments being in PruFund. The third quarter of 2016 saw the launch of our new Retirement Account product, a fully digital proposition which offers one account for both pension savings and income drawdown and can accept transfers from existing plans. The value of UK invested assets on platforms continues to increase, and we are seeking to develop new solutions to target this opportunity.

#### **Wholesale**

There were no new bulk annuity buy-in insurance agreements in 2016 following Prudential UK&E s withdrawal from this market in 2016.

## **Long-term Products**

Prudential UK&E s long-term products in the United Kingdom consist of life insurance, pension products and pensions annuities. The following table shows Prudential UK&E s new business insurance and investment premiums by product line for the periods indicated. New business premiums include deposits for policies with limited or no life contingencies. Prudential UK&E also distributes life insurance products, primarily investment bonds, in other European countries and has a business in Poland which primarily sells with-profits savings and protection products. The volume of such business is relatively small and is included in the table below.

	Year En	Year Ended 31 December		
		£m		
	2016	2015	2014	
Individual annuities	546	565	1,065	
Bonds	3,834	3,327	2,934	
Corporate Pensions	231	310	230	
Individual Pensions	2,567	1,217	530	
Income drawdown	1,649	1,024	352	

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Other products	1,186	691	26
Wholesale	-	1,508	1,710
Total New business premiums (excluding PruHealth and PruProtect businesses)	10,013	8,642	6,847
PruHealth and PruProtect businesses**	-	-	23
Total new business premiums	10,013	8,642	6,870

<sup>\*</sup> Following the disposal of Prudential UK&E s 25 per cent interest share in PruProtect and PruHealth in November 2014, the 2014 comparatives have been have been adjusted to show the premiums of those businesses separately. Of the total new business premiums of £10,013 million (2015: £8,642 million; 2014: £6,870 million), £9,836 million (2015: £8,463 million; 2014: £6,681 million) were for single premiums and £177 million (2015: £179 million; 2014: £166 million) were for regular premiums.

#### Pension Annuities (including Wholesale)

Prudential UK&E offers individual conventional immediate annuities that are either fixed or retail price indexed (referred to as RPI), where annuity payments are guaranteed from the outset. Our with-profits annuity proposition, where annuity payments are variable dependent on the investment performance of underlying assets but with an income floor, was withdrawn from the market in the third quarter of 2016.

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A total of £546 million of individual annuities were sold in 2016. Of this total, £418 million was sold through internal vesting, that is existing Prudential UK&E customers with maturing pension policies. The other £128 million were sold to new customers, typically individuals with a pension maturing with another provider who chose Prudential UK&E to provide their annuity. Prudential UK&E s immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products. The primary risks to Prudential UK&E from immediate annuity products are mortality improvements and credit risk. Prudential UK&E withdrew from the external intermediated annuity market in 2016. Prudential UK&E also took steps to curtail retail sales by establishing an annuity panel arrangement with a number of firms to provide annuities to its retiring customers. This new service will be phased-in over the course of 2017.

#### Conventional Annuities

Prudential UK&E s conventional annuities include level (non-increasing), fixed increase and RPI annuities. Prudential UK&E s fixed increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder s life. The RPI annuities provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK Retail Prices Index. In 2016, new business premiums for RPI annuities were £3 million. In 2016, new business premiums of level and fixed increase conventional annuities amounted to £492 million.

#### With-profits Annuities

Prudential UK&E offered with-profits annuities to customers from 1991 to 2016. These combine the income features of annuity products with the investment smoothing features of with-profits products enabling policyholders to obtain equity-type returns over time. In 2016, Prudential UK&E s premiums for this business were £51 million.

## Pension and Flexi-income Drawdown Products

Prudential UK&E provides corporate, individual pension and flexi-access drawdown products. Pension products are tax advantaged long-term savings products that comply with rules established by the HM Revenue and Customs (HMRC) and are designed to supplement state provided pensions.

These products provide policyholders with a number of options at retirement. From age 55 onwards, policyholders may elect to use part or all of their maturity benefits to purchase a pension annuity, they may choose to draw-down funds without purchasing an annuity, they may delay taking any benefits, take cash or take a combination of these options. They are also permitted to take a portion as a tax-free lump sum.

Income drawdown products have historically provided a bridge between pensions and annuities, allowing customers to access pension savings from age 55, subject to certain limits. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth. Prior to the pension reforms announced in the 2014 UK Budget, the market had seen good growth, reflecting an increasingly sophisticated consumer population and the rising incidence of second careers and semi-retirement as a result of increasing longevity. This growth accelerated in the interim period created by the Budget 2014 announcement before the introduction of pension reforms in April 2015 and has continued since. Income drawdown has proved popular with customers seeking greater flexibility than that offered by a traditional annuity product, but preferring to draw funds gradually rather than withdrawing all of their savings as cash. Depending on the size of their pension pot and the individual s tax position, it may also be more tax efficient for a customer to invest in a drawdown product rather than to take cash. Many of the pension products Prudential UK&E offers are with-profits products or offer the option to have all or part of the contributions allocated to the with-profits fund. Where funds invested in the with-profits fund

are withdrawn prior to the pension date specified by the policyholder, Prudential UK&E may apply a market value adjustment (MVA) to the amount paid out. MVAs do not apply to the PruFund investment options. The remaining pension products are non-participating products, which include unit-linked products.

Individual Pensions and Income Drawdown

Prudential UK&E s individual pension range offers unit-linked and unitised with-profits products, including products that meet the criteria of the UK government s stakeholder pension program.

Prudential UK&E launched its new Retirement Account proposition, which offers one account for both pension savings and income drawdown and can accept transfers from existing plans, to the intermediated market,

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including its own advised sales force, PFP, towards the end of the third quarter of 2016. It is a digital proposition with an open charging structure separating charges out for the tax wrapper, funds and guarantees that is intended to offer an improved service to advisers and customers. The proposition has been well received in the market, securing significant sales by the end of 2016.

For products with drawdown features, the investment risk and mortality risk remains with the policyholder, payments are not guaranteed, and tend to cost more to administer. In the past, this has meant that the option to draw down income tended to apply mainly to more sophisticated policyholders commonly with larger retirement funds. The changes in the rules governing access to pension savings mean that consumers now have more choice and flexibility in how they access their retirement income and drawdown has become more popular for customers starting to take income in retirement. Any income taken from pension savings in excess of the allowable tax-free lump sum is taxable at a customer s marginal tax rate. Many more customers than before are taking their tax free cash and leaving their funds invested. To further extend the proposition and to continue to meet customers needs for secure income whilst still retaining some flexibilities, a minimum income guarantee is offered as an additional option.

Prudential UK&E continues to offer its Direct to Customer (D2C) flexi-access drawdown proposition Pension Choices Plan launched late in 2015. It has proved popular with Prudential UK&E customers with maturing pension policies, offering an alternative to the more traditional annuity, without the need for financial advice. It is a simpler proposition to that offered via financial intermediaries, but with fewer investment options offered.

### Corporate Pensions

There are two categories of corporate pension products: defined benefit and defined contribution. Prudential UK&E has an established defined benefit plan client base covering the small to medium sized employer market. Prudential UK&E s defined contribution client base ranges from small unlisted companies to some of the largest companies in the United Kingdom as well as a number of clients in the public sector (in particular where Prudential UK&E offers the Additional Voluntary Contribution ( AVC ) facility). Additional Voluntary Contribution plans enable employees to make additional pension contributions, either regularly or as a lump sum, to supplement their occupational pension plans. Prudential UK&E administers corporate pensions for over 600,000 scheme members sponsored by some of the UK s largest employers and has also built a very strong position in the provision of with-profits AVC arrangements. Prudential UK&E provides AVCs to 74 of the 99 Local Government Authorities in the UK.

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

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

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

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

#### **Bonds**

#### Onshore Bonds

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

PIP also gives financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In 2016, new business premiums from the unit-linked option within on-shore bond wrappers, including PIP were £165 million.

Prudential UK&E offers a unitised and smoothed with-profits investment fund called PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer with a choice of Cautious, Growth or Risk-Managed funds. PruFund also offers clients an optional guarantee on the initial investment in either the Cautious or Growth funds with a term of ten years. PruFund is available across Prudential UK&E s range of tax wrappers including individual pensions, income drawdown, ISA and onshore and offshore bonds. In 2016, total bonds new business premiums attributable to PruFund, including new business through PIP, was £2,608 million.

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

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

In addition Prudential UK&E offers an open architecture onshore bond, the Prudential Onshore Portfolio Bond, which allows customers to access a wide range of quoted UK investments. New business premiums from this product were £78 million in 2016. The new business premiums for other onshore bonds were £106 million in 2016.

### Offshore Bonds

Prudential UK&E s offshore bond products are the Prudential International Investment Bond and the Prudential International Investment Portfolio offering clients access to a wide range of quoted UK investments. Prudential UK&E s offshore bond sales grew by 17 per cent to £877 million in 2016.

#### Other Products

Other products include PruFund ISA, life insurance and equity release mortgages.

#### PruFund ISA

On 26 February 2015 Prudential UK&E added the PruFund range of investment funds to the Capita Prudential ISA to offer clients a level of smoothing in the current volatile market within a tax efficient wrapper. New business premiums in 2016 for this product were £1,143 million.

### Life Insurance Products

Prudential UK&E s UK life insurance products are predominantly pure protection (term) products, and include the PruProtect product previously sold through an associate company. On 14 November 2014 Prudential sold its remaining 25 per cent share in PruProtect to Discovery and no further sales are included after that date.

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Until January 2016, PAC continued to write PruProtect business (renamed VitalityLife) under a white labelling agreement but had no economic interest in the business written. From that date Discovery commenced writing business through its own UK company, Vitality Life. Small amounts of pipeline and top up business continue to be written by PAC

Equity Release Mortgage

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

## Shareholders Interests in Prudential UK&E s Long-term Insurance Business

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

#### With-profits Products

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

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

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

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

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

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

the effect of taxation;

management expenses, charges and commissions;

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

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

However, Prudential UK&E does not take into account the surplus assets of the long-term fund, or investment return earned on them, in calculating asset shares. The determination of final bonuses takes into account asset shares, as well as the need to smooth claim values and payments from year to year, competitive considerations and the desire to treat customers fairly.

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

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

In 2016, PAC declared a total surplus of £2,198 million (2015: £2,208 million) from PAC s primary with-profits sub-fund, of which £1,983 million (2015: £1,994 million) was added to with-profits policies and £215 million (2015: £214 million) was distributed to shareholders. These amounts included annual bonus rates of 1.50 per cent for Prudence Bond and 1.50 per cent for personal pensions.

The closed Scottish Amicable Insurance Fund (SAIF) declared total bonuses in 2016 of £349 million compared with £358 million in 2015. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business.

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

### Surplus Assets in PAC s With-profits Fund

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

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

### Support for with-profits sub-funds by shareholders funds

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

the annual distribution to shareholders or to contribute shareholders funds to the with-profits sub-funds to provide financial support.

Matters relating to with-profits sub-funds:

Pension mis-selling review The UK insurance regulator required all UK life insurance companies to review sales of personal pensions policies for potential mis-selling. Offers to all cases were made by 30 June 2002. Costs arising from this review are met by the excess assets of the PAC with-profits sub-fund and hence have not been charged to the asset shares used in the determination of policyholder bonus rates. Prudential has

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given an assurance that these deductions from excess assets will not impact its bonus or investment policy for policies within the with-profits sub-funds that were in force at 31 December 2003. This assurance does not apply to new business since 1 January 2004. In the unlikely event that such deductions would affect the bonus or investment policy for the relevant policies, Prudential has stated it would make available support to the sub-fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged.

Scottish Amicable Insurance sub-fund Policies within this sub-fund (a with-profits sub-fund closed to new business) contain minimum levels of guaranteed benefit to policyholders. Should the assets of the sub-fund be inadequate to meet the guaranteed benefit obligations of the policyholders of SAIF, the PAC with-profits sub-fund would be liable to cover any such deficiency in the first instance.

In addition, certain pensions products within this sub-fund have guaranteed annuity rates at retirement, for which a provision of £571 million was held within the sub-fund (2015: £412 million).

Guaranteed annuities A provision for guaranteed annuity products of £62 million was held (2015: £47 million) in the PAC with-profits sub-fund.

### **Intra-group capital support arrangements**

Prudential and PAC have put in place intra-group arrangements to formalise circumstances in which capital support would be made available by Prudential. While Prudential considers it unlikely that such support will be required, the arrangements are intended to provide additional comfort to PAC and its policyholders.

In addition, Prudential has put in place intra-group arrangements to formalise undertakings by Prudential to the regulators of the Hong Kong subsidiaries regarding their solvency levels.

### **Non-participating Business**

The profits from almost all of the new non-participating business accrue solely to shareholders. Such business is written in PAC, or in various shareholder-owned direct or indirect subsidiaries. The most significant of these was Prudential Retirement Income Limited (PRIL), which wrote conventional annuities including all new conventional annuities arising from vesting deferred annuity and personal pension policies in the with-profits sub-fund of PAC. On 1 October 2016 this business was transferred into PAC following a Part VII Transfer under the Financial Services and Markets Act 2000. There is also a substantial volume of in-force non-participating business in PAC s with-profits sub-fund, part of which was originally written in that fund s wholly owned subsidiary Prudential Annuities Limited (PAL). On 1 October 2014, the business of PAL transferred into PAC following a Part VII Transfer under the Financial Services and Markets Act 2000.

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

#### **United Kingdom Asset management**

#### Introduction

M&G is the UK and European fund manager of the Prudential Group with responsibility for investments on behalf of both internal and external clients.

As at 31 December 2016, M&G:

had responsibility for £265 billion of investment on behalf of both internal and external clients; and has been recognised for its investment expertise with awards across nearly all its asset categories in 2016, including Property Manager of the Year at the European Pension Awards and Fixed Income Manager of the Year at the Local Authority Pension Fund Awards.

### Market overview

The world s population is ageing: by 2020, there will be more people aged 65 and above than children under five, according to the US Census Bureau. The United Nations estimates that this trend will continue, with over 15 percent of the global population being aged over 65 by 2050. This demographic shift coincides with changes in retirement planning as governments and employers shift more responsibility to individuals, resulting in growing demand for asset management services.

The European asset management market is already the second-largest in the world, with net assets of £8.2 trillion, while the UK M&G s core market is the second-largest national market, with £1.2 trillion, and is a global centre of excellence for investment management.

As the appetite for long-term savings products grows, demand for alternative investment strategies and solutions, such as direct lending and long-term investment in infrastructure equity is expected to grow. M&G is well placed to benefit from this trend, given its expertise across a diverse range of assets, a record of innovation and strong distribution relationships.

### Market backdrop in 2016<sup>1</sup>

Economic pessimism, political risk and central bank quantitative easing saw many government bonds offering negative real yields in the first half of 2016. There was a significant shift mid-year in investor sentiment, as assets flowed away from bonds and bond proxies back towards equities, particularly financial, energy and materials stocks. This trend accelerated following the US election and the possibility of looser US fiscal policy boosting economic growth in 2017: over 22 billion was withdrawn from fixed-income funds by European investors in November alone. An exception was the inflation-linked bond sector, which attracted net flows of over 10 billion in 2016 as investors sought protection from the inflationary impact of higher growth expectations in 2017.

Funds, excluding money market funds, in the UK ended 2016 strongly, with net inflows double those of the next-largest European market during the last two months of 2016. Total net sales of Investment Association-registered UK mutual funds were £13 billion during 2016, down from £22 billion in the previous year. In Europe, net sales were 213 billion, down from 498 billion in the previous year.

### **Customers**

Throughout our 85-year history, M&G has maintained its purpose: to help our customers prosper by putting their long-term savings to work. Our customers have always been at the heart of what we do.

Today we manage the savings of millions of people in the UK, Europe and the rest of the world. These include direct or intermediated investors in our open-ended investment funds, members of pension schemes or other long-term savings schemes who invest through financial institutions, and Jackson and Prudential policyholders, including the Prudential UK with profits Fund.

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All our customers benefit from our conviction-led, long-term approach to asset management, applied across the full range of asset types: cash, equities, bonds, property and alternatives. We are constantly developing our capabilities to offer our customers strategies that meet their needs, whatever the market conditions.

#### **Products**

M&G has a range of 59 open-ended funds domiciled in the UK and is developing a similar range of funds domiciled in Luxembourg. We aim to offer customers attractive long-term investment returns from a broad choice of products across diverse geographies, asset classes and strategies. Some of our products offer solutions to very specific investor needs. The M&G Episode Income Fund, for example, aims to deliver high and rising levels of income from a diverse range of different assets, which is important to many investors at a time of historically low interest rates and negative bond yields. We also manage segregated mandates on behalf of pension schemes, wealth funds and other institutional investors, as well as a number of alternative investment strategies.

*Equities:* throughout our long history, we have favoured a stock selection approach, building portfolios from the bottom up. We are known for our long-term investment views, which give us credibility and influence when representing the views and interests of our end investors to company management.

*Fixed Income*: M&G is one of Europe s largest fixed-income investors, with one of the biggest, most experienced in-house credit research teams. Our end investors benefit from our expertise in the full range of fixed-income investments, ranging from sovereign debt to private loans. Among our best-known and most successful strategies are the M&G Optimal Income Fund, which celebrated the 10<sup>th</sup> anniversary of its UK launch in 2016, and the M&G Alpha Opportunities Fund.

*Multi-asset:* M&G s range of multi-asset funds, designed for investors seeking to spread risk across a mix of assets, has again proven popular with customers in 2016. The M&G Prudent Allocation Fund, launched in 2015 to cater specifically for European investors with a lower appetite for risk, was one of our bestselling funds in 2016. In December, we launched the M&G Global Target Return Fund, a new multi-asset fund aimed at investors seeking reasonable returns with managed volatility.

**Real estate:** M&G invests in, and manages, property around the globe. Our £26 billion portfolio covers the three commercial sectors of retail, office and industrial. We have a growing franchise in UK Residential Property. M&G Real Estate s core Asia property fund celebrated its 1\(\theta\) anniversary in 2016 and is one of the largest and most diversified Asia property portfolios. There are now investments of more than US\$1.7 billion in the Asia Property Fund.

Alternative assets: M&G is a leading investor in a diverse range of private and illiquid assets such as commercial real estate debt, infrastructure debt and equity, and direct lending, collectively known as alternatives. These are attractive options for institutional investors looking to match long term liabilities with long term returns, either at fixed or floating rates. They are also a key source of funding for public and private infrastructure projects and businesses that might otherwise struggle to access competitive financing.

#### **Distribution**

With offices in 16 countries<sup>2</sup>, M&G is able to stay close to our customers and the intermediaries who distribute our products. Our open-ended retail funds are registered for distribution in 23 jurisdictions<sup>3</sup> in Europe and Asia, while our institutional investment strategies are available to investors in many markets around the world, including North America.

We are also investing in online distribution in the UK, building on the insights we gain from the Client Council, a group of 500 customers who invest directly with us and who help us develop our products, services and investor communications.

### **Investment for growth**

M&G is investing in technology and operational infrastructure so we can take full advantage of the opportunities in the fast evolving distribution and regulatory landscape in which we operate. In 2016, we began implementation of Aladdin, a new global risk and portfolio management platform, which is being adopted across the Prudential Group s asset management businesses. This will significantly advance our data capabilities and operational efficiency.

We also opened a new investment platform in Luxembourg, which gives us new capacity to distribute our funds to European customers based outside the UK.

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

		At 31 December £bn		
	2016	2015	2014	
Retail fund management	64	61	74	
Institutional fund management	73	65	63	
Internal fund management	128	120	127	
Total	265	246	264	

<sup>&</sup>lt;sup>1</sup> Source: Broadridge FundFile as at 31 December 2016 in GBP and EUR. Where referenced, the European asset management market refers to both cross border and domestic markets and net sales data is based on estimated net sales data, All UK data is sourced from the Investment Association as at 31 December 2016 and based on the UK onshore and offshore data.

<sup>&</sup>lt;sup>2</sup> Includes the UK head office and PPM South Africa.

<sup>&</sup>lt;sup>3</sup> Europe includes the UK. Restricted distribution in Singapore.

### Competition

#### General

There are other significant participants in each of the financial services markets in which Prudential operates. Its competitors include both mutual and stock financial companies. In addition, regulatory and other developments in many of Prudential s markets have blurred traditional financial service industry lines and opened the market to new competitors and increased competition. In some of Prudential s markets, other companies may have greater financial resources, allowing them to benefit from economies of scale, and may have stronger brands than Prudential does in that market.

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

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

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

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

### Asia

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

The global life insurers that are Prudential s competitors in the Asia Pacific region include AIA, Allianz, Aviva, AXA, and Manulife. Other competitors relevant in some of Prudential s key markets include HSBC Life in Hong Kong, Muang Thai Life in Thailand, Great Eastern in Singapore and Malaysia, and China Life, China Pacific and Ping An in China. Prudential s principal competitors in respect of its fund management operations across the region largely comprise multinational asset managers such as J.P. Morgan Asset Management, Schroders, HSBC Global Asset Management, Franklin Templeton, Fidelity Worldwide Investment and Aberdeen Asset Management.

### **United States**

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

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Jackson s competitors in the United States include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies. National banks, in particular, may become more significant competitors in the future for insurers who sell annuities, due to current legislation, court decisions and regulatory actions. Jackson s principal life insurance company competitors in the United States include AIG, Prudential Financial, MetLife, Lincoln National, AXA Financial, AEGON and Allianz.

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

### **United Kingdom**

Prudential UK&E and M&G s principal competitors include many of the major retail financial services platforms and fund management companies operating in the United Kingdom. These companies include Aviva, Legal & General, Standard Life, Scottish Widows, Aegon, Royal London, Zurich Financial Services, Liverpool Victoria, Fidelity, Invesco Perpetual, Jupiter, Columbia Threadneedle, Schroders and BlackRock. Prudential competes with other providers of financial products to be included on financial advisors panels of preferred providers.

#### **Sources**

Throughout this annual report, Prudential describes the position and ranking of its overall business and individual business units in various industry and geographic markets. The sources for such descriptions come from a variety of conventional sources generally accepted as relevant business indicators by members of the financial services industry. These sources include information available from the Annuity Specs, Asia Asset Management Magazine, Association Association of British Insurers, Association of Vietnamese Insurers, Association of Unit Trusts and Investment Funds, Fitch, Hong Kong Federation of Insurers, Hong Kong Office of the Commissioner of Insurance, HSBC Global Research, Insurance Regulatory and Development Authority of India, Insurance Services Malaysia Berhad, Investment Management Association, Life Insurance Marketing and Research Association (LIMRA), Life Insurance Association of Malaysia, Life Insurance Association of Singapore, Life Insurance Association of Taiwan, Lipper Inc., Morningstar, Moody s, Neilsen Net Ratings, Propriety Research, Service Quality Management Group, SNL Financial, Standard & Poor s, Thai Life Assurance Association, The Asset Benchmark Research, The Advantage Group, The Asset, Townsend and Schupp and UBS.

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### **Financial Performance**

### **IFRS Critical Accounting Policies**

Prudential s discussion and analysis of its financial condition and results of operations are based upon Prudential s consolidated financial statements, which have been prepared in accordance with IFRS as issued by the IASB and as endorsed by the EU. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2016, there were no unendorsed standards effective for the three years ended 31 December 2016 affecting the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, Prudential s financial information for the three years ended 31 December 2016 has been prepared in accordance with IFRS as issued by the IASB. Prudential adopts mandatory requirements of new or altered EU-adopted IFRS standards when required, and may consider earlier adoption where permitted and appropriate in the circumstances.

The preparation of these financial statements required Prudential to make estimates and judgements that affect the reported amounts of assets, liabilities, and revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Prudential evaluates its estimates, including those related to long-term business provisioning and the fair value of assets.

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially give rise to different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to the policies referenced below which are described further in the notes to the consolidated financial statements.

	Reference to the disclosure notes in the consolidated
Critical accounting policies	financial statements
Classification of insurance and investment contracts	A3.1(a)
Measurement of policyholder liabilities and unallocated surplus of with-profits	A3.1(a)
Measurement and presentation of derivatives and debt securities of US insurance operations	A3.1(b)
Presentation of results before tax	A3.1(b)
Segmental analysis of results and earnings distributable to shareholders	A3.1(b)

The critical accounting policies referenced above are critical for those that relate to the Group s shareholder financed business. In particular this applies for Jackson which is the largest shareholder backed business in the Group. The policies are not critical in respect of the Group s with-profits business. This distinction reflects the basis of recognition of profit and accounting treatment of unallocated surplus of with-profits funds as a liability, as described elsewhere in these financial statements.

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In determining the measurement of the Group s assets and liabilities and in preparing financial statements, more generally, estimates and judgements are required. The critical aspects are set out below by reference to and discussed in the following accounting policies and other notes to the consolidated financial statements.

	Reference to the disclosure notes in the consolidated
Critical accounting estimates and assumptions	financial statements
Classification of insurance and investment contracts	A3.1(a)
Measurement of policyholder liabilities and unallocated surplus of with-profits	A3.1(a); and C4.2
Deferred acquisition costs for insurance contracts	A3.1(c); and C4.2
Financial investments Valuation	A3.1(c)
Financial investments Determining impairment related to financial assets	A3.1 (c)
Additional quantitative information on the impairment and realised gains/losses recognised	
on the available-for-sale debt securities of US insurance operations	B1.2, C3.2 (g)
Additional quantitative information on the movement in the statement of financial position value of the available-for-sale debt securities of US insurance operations and those which are	
in a gross unrealised loss position.	C3.2(b), C3.2 (c)
Intangible assets carrying value of distribution rights	A3.1 (c)

### **Summary Consolidated Results and Basis of Preparation of Analysis**

The following table shows Prudential s consolidated total profit for the years indicated.

	Actual Exchange Rate Year Ended 31 December £m		
	2016	2015	2014
Total revenue, net of reinsurance	71,842	41,305	60,126
Total charges, net of reinsurance	(68,812)	(38,222)	(57,275)
Share of profits from joint ventures and associates, net of related tax	182	238	303
Profit before tax (being tax attributable to shareholders and			
policyholders returns)*	3,212	3,321	3,154
Tax attributable to policyholders returns	(937)	(173)	(540)
Profit before tax attributable to shareholders	2,275	3,148	2,614
Tax charge	(1,291)	(742)	(938)
Less: tax attributable to policyholders returns	937	173	540
Tax charge attributable to shareholders returns	(354)	(569)	(398)
Profit for the year	1,921	2,579	2,216

\* This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders. This is principally because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure (which is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the PAC with-profits fund after adjusting for taxes borne by policyholders) is not representative of pre-tax profits attributable to shareholders. See Presentation of results before tax under IFRS Critical Accounting Policies section above for further explanation.

Under IFRS, the pre-tax GAAP measure of profits is profit before policyholder and shareholder taxes. This measure is not relevant for reflecting pre-tax results attributable to shareholders for two reasons. Firstly, this profit measure represents the aggregate of pre-tax results attributable to shareholders and a pre-tax amount attributable to policyholders. Secondly, the amount is determined after charging the transfer to the liability for unallocated surplus, which in turn is determined in part by policyholder taxes borne by the ring-fenced with-profits funds. It is noted that this circular feature is specific to with-profits funds in the UK, and other similarly structured overseas funds, and should be distinguished from other products, which are referred to as with-profits and the general accounting treatment of premium or other policy taxes.

Accordingly, Prudential has chosen to explain its consolidated results by reference to profits for the year, reflecting profit after tax. In explaining movements in profit for the year, reference is made to trends in profit before shareholder tax and the shareholder tax charge. The explanations of movement in profit before shareholder tax are shown below by reference to the profit analysis applied for segmental disclosure as shown in note B1 to the consolidated financial statements. This basis is used by management and reported externally to the holders of shares listed on the UK, Hong Kong and Singapore exchanges and to the financial markets in those countries. Separately, in this section, analysis of movements in profits before shareholder tax is provided by nature of revenue and charges.

# Explanation of Movements in Profits after Tax and Profits before Shareholder Tax by Reference to the Basis Applied for Segmental Disclosure

### (a) Group overview

Profit for the year after tax for 2016 was £1,921 million compared with £2,579 million for 2015. The decrease primarily reflects the movement in profit before tax attributable to shareholders, which decreased from a profit of £3,148 million in 2015 to a profit of £2,275 million in 2016, which was partially offset by a decrease in the tax charge attributable to shareholders from £569 million in 2015 to £354 million in 2016.

The decrease in the total profit before tax attributable to shareholders from £3,148 million in 2015 to £2,275 million in 2016 reflects an improvement in operating profit based on longer-term investment returns of £287 million from £3,969 million in 2015 to £4,256 million in 2016 which was more than offset by an adverse change in non-operating items of £1,160 million, from negative £821 million to negative £1,981 million. The increase of £287 million or 7 per cent in operating profit based on longer-term investments includes a positive exchange

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translation impact of £364 million. Excluding the effect of currency volatility, on a constant exchange rate basis, the Group operating profit based on longer-term investment returns decreased by £77 million or 2 per cent to £4,256 million with increases in Asia and the US offset by the expected decline in the contribution from our UK businesses.

The increased charge for non-operating items of £1,160 million is primarily due to the adverse change in short-term fluctuations in investment returns from negative £755 million in 2015 to negative £1,678 million in 2016 and the inclusion in 2016 of a loss attaching to the held for sale Korea life business of £227 million. In November 2016 the Group announced the sale of its Korea life insurance business, PCA Life Insurance Co Ltd. The completion of this sale is subject to regulatory approval. Refer to sub-section headed Corporate transactions and note D1 to the consolidated financial statements for further information.

The effective rate of tax at the total profit level was 16 per cent in 2016 compared with 18 per cent in 2015. The decreased rate principally reflects a smaller overall contribution to the total profit from Jackson which attracts a higher rate of tax than other operations. Further details are provided in note B5 to the consolidated financial statements.

Profit for the year after tax for 2015 was £2,579 million compared with £2,216 million for 2014. The increase primarily reflected the movement in profit before tax attributable to shareholders, which increased from a profit of £2,614 million in 2014 to a profit of £3,148 million in 2015, which was partially offset by an increase in the tax charge attributable to shareholders from £398 million in 2014 to £569 million in 2015.

The increase in the total profit before tax attributable to shareholders from £2,614 million in 2014 to £3,148 million in 2015 reflected an improvement in operating profit based on longer-term investment returns from £3,154 million in 2014 to £3,969 million in 2015 and an adverse change in non-operating items of £281 million, from negative £540 million to negative £821 million. The increase of £821 million or 26 per cent in operating profit based on longer-term investments includes a positive exchange translation impact of £104 million. Excluding the currency volatility, on a constant exchange rate basis, the Group operating profit based on longer-term investment returns increased by £711 million or 22 per cent to £3,969 million, driven by the improved performance in our life operations in Asia, the US and the UK.

The increased charge for non-operating items of £281 million is primarily due to the adverse change in short-term fluctuations in investment returns from negative £605 million in 2014 to negative £755 million in 2015. In addition, in 2014, the Group sold its 25 per cent equity stake in the PruHealth and PruProtect businesses resulting in a profit on disposal of £86 million recorded as a non-operating item. During 2015, investment markets were volatile, reflecting growing concerns on the outlook for global growth, the consequences of monetary policy actions and unease caused by the steep decline in commodities prices. The fourth quarter in particular saw weakening equity markets and widening credit spreads across most of the major global economies. Although we took steps to reduce the investment market sensitivity of our earnings and balance sheet in recent years, we remain significant long-term holders of financial assets. Short-term fluctuations in the value of these assets are reported outside the operating result, which is based on longer-term assumptions for investment returns. Currency values in the countries in which we operate also fluctuated in the course of 2015. As a significant proportion of our earnings and capital is US dollar denominated, the weaker sterling benefited our reported results, shareholders equity and solvency.

The effective rate of tax at the total profit level was 18 per cent in 2015 compared with 15 per cent in 2014. The increased rate principally reflects a larger overall contribution to the total profit from Jackson which attracts a higher rate of tax than other operations. Further details are provided in note B5 to the consolidated financial statements.

### (b) Summary by business segment and geographical region

The Group s operating segments as determined under IFRS 8 are insurance operations split by territories in which the Group conducts business, which are Asia, the United States and the United Kingdom, and asset management operations split into M&G, which is the Group s UK and European asset management business, Eastspring Investments, which is the Asian asset management business and the US broker-dealer and asset management business.

The following table shows Prudential s IFRS consolidated total profit (loss) for the years indicated presented by summary business segment and geographic region. The accounting policies applied to the segments below are the same as those used in the Group s consolidated accounts.

	Year ended 31 December 2016 £m				
			Un	allocated	
	Asia	US	UKcor	porate**	Total
Insurance operations	804	594	836	-	2,234
Asset management*	124	(3)	326	-	447
Total profit attributable to the segments	928	591	1,162	-	2,681
Unallocated corporate	-	-	-	<b>(760)</b>	<b>(760)</b>
Total profit (loss) for the year	928	591	1,162	<b>(760)</b>	1,921
	Yea	r ended 31 Dec	cember 2015 £	m (AER)	

			Una	allocated	
	Asia	US	UKcor	porate**	Total
Insurance operations	871	963	872	-	2,706
Asset management*	101	7	323	-	431
Total profit attributable to the segments	972	970	1,195	-	3,137
Unallocated corporate	-	-	-	(558)	(558)
Total profit (loss) for the year	972	970	1,195	(558)	2,579

	Year ended 31 December 2014 £m (AER)				
			Una	allocated	
	Asia	US	UK+cor	porate**	Total
Insurance operations	1,048	249	1,050	-	2,347
Asset management*	78	6	372	-	456
Total profit attributable to the segments	1,126	255	1,422	-	2,803
Unallocated corporate	-	-	-	(587)	(587)
Total profit (loss) for the year	1,126	255	1,422	(587)	2,216

<sup>\*</sup>For the US, including the broker-dealer business.

### Profit from insurance operations

Total profit from insurance operations in 2016 was £2,234 million compared with £2,706 million in 2015 and £2,347 million in 2014. All of the profits from insurance operations in 2016, 2015 and 2014 were from continuing operations. The movement in profits for insurance operations can be summarised as follows:

	Year 1	Year Ended 31 December £m			
	2016	2015	2014		
Profit before shareholder tax	2,598	3,310	2,798		
Shareholder tax charge	(364)	(604)	(451)		
Profit after tax	2,234	2,706	2,347		

<sup>\*\*</sup>Representing central operations.

<sup>+</sup>Includes the results of the sold PruHealth and PruProtect businesses.

The decrease of £712 million in profit before tax attributable to shareholders, from £3,310 million in 2015 to £2,598 million in 2016 is primarily driven by an increased loss in non-operating losses of £1,038 million, from a loss of £747 million in 2015 to a loss of £1,785 million in 2016, driven primarily by the adverse change in short-term fluctuations in investment returns and the inclusion in 2016 of a loss attaching to the held for sale Korea life business of £227 million. The impact of the increase in non-operating losses of £1,038 million is partially offset by an consolidated increase of £326 million in operating profit based on longer-term investment returns. This increase in operating profit based on longer-term investment returns is driven by an increase in Asia (from £1,171 million to £1,503 million) reflecting continued business momentum and the US (from £1,691 million to £2,052 million) mainly due to growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread income. These increases were partially offset by a decrease in the UK from £1,195 million to £828 million, as a result of significantly reduced profits from annuity new business following our withdrawal from the bulk annuity

market in 2016, the lower contribution from actions to support solvency and a provision for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress. The increase of £326 million in operating profit based on longer-term investments includes a positive exchange translation impact of £349 million.

The effective shareholder tax rate on profits from insurance operations decreased to 14 per cent in 2016 compared with 18 per cent in 2015. The increased rate reflects a smaller overall contribution to the total profit from Jackson which attracts a higher rate of tax. Further details are included in Note B5 to the consolidated financial statements.

The increase of £512 million in profit before tax attributable to shareholders, from £2,798 million in 2014 to a profit of £3,310 million in 2015 was primarily driven by an increase in operating profit based on longer-term investment returns in the US (from £257 million to £1,199 million), a decrease in Asia (from £1,220 million to £1,036 million) and the UK (from £1,321 million to £1,075 million). The consolidated increase of £821 million was offset by an increased loss in non-operating losses of £287 million, from a loss of £572 million in 2014 to a loss of £859 million in 2015. The increase of £821 million in operating profit based on longer-term investments included a positive exchange translation impact of £104 million. The increase in operating profit based on longer-term investment returns reflected the growth in the scale of the insurance operations, driven primarily by positive business inflows.

The effective shareholder tax rate on profits from insurance operations increased to 18 per cent in 2015 compared with 16 per cent in 2014. The increased rate reflects a larger overall contribution to the total profit from Jackson which attracts a higher rate of tax. Further details are included in Note B5 to the consolidated financial statements.

In order to understand how Prudential s results are derived it is necessary to understand how profit emerges from its business. This varies from region to region, primarily due to differences in the nature of the products and regulatory environments in which Prudential operates.

#### Asia

### Basis of profits

The assets and liabilities of contracts classified as insurance under IFRS 4 are determined in accordance with methods prescribed by local GAAP and adjusted to comply, where necessary, with grandfathered UK GAAP. Under IFRS 4, subject to the conditions of that standard, the continued application of grandfathered UK GAAP in this respect is permitted.

For Asia operations in countries where local GAAP is not well established and in which the business is primarily non-participating and linked business, the measurement of the insurance assets and liabilities is determined substantially by reference to US GAAP principles. This basis is applied in India, Taiwan and, until its sale in 2015, Japan. For with-profits business in Hong Kong, Singapore and Malaysia, the basis of profit recognition is bonus driven as described under United Kingdom Basis of Profits below.

### Comparison of total profit arising from Asia insurance operations

The following table shows the movement in profit arising from Asia insurance operations for the years indicated.

Year Ended 31 December £m 2016 2015 2014

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Profit before shareholder tax	1,043	1,036	1,220
Shareholder tax charge	(239)	(165)	(172)
Profit after tax	804	871	1,048

The marginal increase of £7 million from the profit before tax attributable to shareholders in 2015 of £1,036 million to a profit of £1,043 million in 2016 primarily reflects an increase of operating profit based on longer-term investment return of £332 million, which was partially offset by an increase in non-operating loss of £325 million. The increase of £332 million in operating profit based on longer-term investments includes a positive exchange

translation impact of £132 million. Excluding the currency volatility, Asia insurance operations operating profit based on longer-term investment returns was up 15 per cent on a constant exchange basis driven by the increase in the contribution from in-force business and reflecting the recurring premium income bias of our in-force book and the highly diverse nature of our earnings by geography and by product.

The change of £325 million from a non-operating loss of £135 million in 2015 to a non-operating loss of £460 million in 2016 was primarily due to a £227 million loss attaching to the held for sale Korea life business in 2016 and the negative change of £88 million in short-term fluctuations in investment returns from £137 million in 2015 to £225 million in 2016. The negative change in short-term fluctuations in investment returns principally reflects the net impact of changes in interest rates and equity markets across the region.

The effective shareholder tax rate increased to 23 per cent in 2016 compared with 16 per cent in 2015, with the movement principally due to the non-tax deductible write down of the Korea life business following the agreement to sell the business.

The decrease of £184 million from the profit before tax attributable to shareholders in 2014 of £1,220 million to a profit of £1,036 million in 2015 primarily reflected adverse change in non-operating items of £337 million, which was partially offset by an increase of £153 million in operating profit based on longer-term investment. The increase of £153 million in operating profit based on longer-term investments included a negative exchange translation impact of £10 million. Excluding the currency volatility, Asia insurance operations operating profit based on longer-term investment returns was up 16 per cent on a constant exchange basis driven by the contribution from the in-force business, reflecting both its larger scale and our regular premium health and protection oriented focus.

The change of £337 million from a non-operating profit of £202 million in 2014 to a non-operating loss of £135 million in 2015 was primarily due to adverse changes in the short-term fluctuations in investment returns of £284 million and a recycled £46 million cumulative exchange loss related to the sale of Japan Life business in 2015. The adverse change of £337 million in 2015 in non-operating items included a negative exchange translation impact of £10 million. The negative short-term fluctuations in investment returns primarily reflected net unrealised losses on fixed income securities, primarily due to rises in bond yields.

The effective shareholder tax rate increased to 16 per cent in 2015 compared with 14 per cent in 2014, with the movement principally due to an increase in losses arising in the current year for which no deferred tax asset has been recognised.

#### **United States**

### Basis of profits

The operating profit on Jackson s business predominantly arises from fee income on variable annuity business, spread income from interest sensitive products, such as fixed annuities and institutional products, and insurance margin, net of expenses measured on a US GAAP basis. In addition, the profit (including non-operating items) in any period include the incidence of gains and losses (including impairment) on assets classified as available-for-sale, fair value movements on derivatives and securities classified as fair valued through profit and loss and value movements on product guarantees.

### Comparison of total profit arising from US insurance operations

The following table shows the movement in profit arising from US insurance operations for the years indicated.

		Year Ended 31 December £m			
	2016	2015	2014		
Profit before shareholder tax	529	1,199	257		
Shareholder tax credit (charge)	65	(236)	(8)		
Profit after tax	594	963	249		

The £670 million decrease in profit before tax attributable to shareholders in 2016 against 2015, is primarily due to an increase of £1,031 million in non-operating loss to £1,523 million, which is partially offset by an increase in operating profit from £1,691 million in 2015 to £2,052 million in 2016.

The increase of £361 million in operating profit based on longer term investment returns includes a positive translation impact of £217 million. Excluding the currency volatility, the increase in operating profit based on longer-term investment return in 2016 on a constant exchange rate basis compared with 2015 was £144 million or 8 per cent primarily as a result of higher fee income from growth in Jackson s separate account asset base and lower amortisation of deferred acquisition costs, which together exceeded the anticipated reduction in spread income.

The non-operating loss increased by £1,031 million from a £492 million loss in 2015 to a loss of £1,523 million in 2016. The increase in non-operating loss was mainly driven by an adverse change in short term fluctuations in investment returns of £1,031 million from a loss of £424 million in 2015 to a loss of £1,455 million in 2016. The negative movement in short-term fluctuations in investment returns mainly reflects the net value movement on the guarantees offered by Jackson and the associated derivatives held to manage market exposures, as described further in the Short-term fluctuations in investment returns section below.

The effective tax rate on profits from US operations was negative 12 per cent in 2016 compared with 20 per cent in 2015 principally driven by a higher negative short-term fluctuations in investment returns, which attracts tax relief at a higher rate than operating profit based on longer-term investment returns in the US operations.

The £942 million increase in profit before tax attributable to shareholders in 2015 against 2014, was primarily due to an increase of £260 million in operating profit based on longer-term investment returns to £1,691 million, together with a decrease in the non-operating loss, which fell by £682 million to £492 million.

The increase of £260 million in operating profit based on longer term investment returns included a positive translation impact of £112 million. Excluding the currency volatility, the increase in operating profit based on longer-term investment return in 2015 on a constant exchange rate basis compared with 2014 was £148 million or 10 per cent primarily as a result of an increase in fee income, which was the US operations main income source, and efficient management of costs.

The decrease in non-operating loss was mainly driven by a favourable change in short-term fluctuations in investment returns of £679 million, which decreased by £679 million from a £1,103 million loss in 2014 to a loss of £424 million in 2015. The positive movement in short-term fluctuations in investment returns mainly reflects the net value movement on the guarantees offered by Jackson and the associated derivatives held to manage market exposures, as described further in the Short-term fluctuations in investment returns section below.

The effective tax rate on profits from US operations increased to 20 per cent in 2015 from 3 per cent in 2014 principally due to the absence of tax relief on the negative net unrealised value movement on derivatives held to manage the Group s exposure to market movements following rises in equity values in 2014. The S&P index ended 2015 roughly in line with year-end 2014 levels.

### **United Kingdom**

#### Basis of profits

Prudential s results comprise an annual profit distribution to shareholders from its UK long-term with-profits fund as well as profits from its annuity and other businesses.

For Prudential s UK insurance operations, the primary annual contribution to shareholders profit comes from its with-profits products. With-profits products are designed to provide policyholders with smoothed investment returns through a mix of regular and final bonuses.

For with-profits business (including non-participating business owned by the PAC with-profits fund), adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on

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the annual declaration of bonuses, shareholder profit for with-profits business is unaffected. This is because IFRS basis profits for the with-profits business, which are determined on the same basis as on grandfathered UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year. Further details on the determination of the bonuses ( regular and final ) are provided in note C4.2(c) to the consolidated financial statements.

The results of the UK shareholder-backed annuity business reflect the inclusion of investment return including realised and unrealised gains and losses. The charge for benefits reflects the valuation rate of interest applied to discount future anticipated payments to policyholders. This rate in turn reflects current market yields adjusted for factors including default risks on the assets backing the liabilities. The level of allowance for default risk is a key assumption. Details are included in note B4 to the consolidated financial statements.

### Comparison of total profit arising from UK insurance operations

The following table shows the movement in profit arising from UK insurance operations for the years indicated.

	Year E	Year Ended 31 December £m		
	2016	2015	2014	
Profit before shareholder tax	1,026	1,075	1,321	
Shareholder tax charge	(190)	(203)	(271)	
Profit after tax	836	872	1,050	

Profit after tax from UK insurance operations of £836 million in 2016 is £36 million lower than the £872 million in 2015.

The decrease in profit before tax attributable to shareholders of £49 million to £1,026 million in 2016 was driven by a decrease of £367 million in operating profit based on longer-term investments returns, which was partially offset by a favourable movement in the short-term fluctuations in investment returns for shareholder-backed business of £318 million from £120 million loss in 2015 to £198 million gain in 2016.

The £367 million, or 31 per cent, decrease in operating profit based on longer-term investment returns reflects lower profit from new annuity business, down from £123 million to £41 million in 2016 as we scale down our participation in the annuity market, a lower contribution from management actions to support solvency, down from £400 million to £332 million, and the establishment of a £175 million provision for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress. Operating profit based on longer term investment returns included general insurance commissions of £29 million in 2016 compared with £28 million for 2015.

The favourable short term fluctuations in investment returns of £198 million reflects gains on bonds backing annuity capital and shareholders funds following the 70bps fall in 15-year UK gilt yields in 2016.

The effective shareholder tax rate on profits from UK insurance operations remained at 19 per cent consistent with 2015.

Profit after tax from UK insurance operations of £872 million in 2015 was £178 million lower than the £1,050 million in 2014.

The decrease in profit before tax attributable to shareholders of £246 million to £1,075 million in 2015 was driven by an increase of £419 million in operating profit based on longer term investments return, which was more than offset

by an adverse movement in the short-term fluctuations in investment returns for shareholder-backed business of £584 million from £464 million gain in 2014 to £120 million loss in 2015 and an adverse movement of £81 million in the other non-operating items.

The £419 million, or 54 per cent, increase in operating profit based on longer-term investment returns was driven by our focused approach on active management of our in-force portfolio and the positive impact of specific management actions taken to position the balance sheet more efficiently under the new Solvency II regime. Operating profit based on longer term investment returns included general insurance commissions of £28 million in 2015 compared with £24 million for 2014.

The adverse short term fluctuations in investment returns of £120 million included net unrealised movements on fixed income assets supporting the capital of the shareholder-backed annuity business. The adverse movement in other non-operating items of £81 million was primarily due to the one-off gain of £86 million arising from the sale of UK insurance operation  $\,$  s 25 per cent equity stake in PruHealth and PruProtect businesses in 2014.

The effective shareholder tax rate on profits from UK insurance operations decreased to 19 per cent compared with 21 per cent for 2014, principally due to the change in the deferred tax balances in 2015 to reflect the reduction in the main rate of UK corporate tax in 2017 and 2020.

### Profit from asset management

The following table shows the movement in profits from asset management for the years indicated.

	Year	Year Ended 31 December £m		
	2016	2015	2014	
Profit before shareholder tax	541	522	573	
Shareholder tax charge	(94)	(91)	(117)	
Profit after tax	447	431	456	

Total profit after tax from asset management marginally increased from £431 million in 2015 to £447 million in 2016. The increase of £19 million in profit before shareholder tax in 2016 compared with 2015 resulted mainly from an increase for our Asia-based asset manager, Eastspring Investments, of £26 million from £115 million in 2015 to £141 million in 2016 and a decrease of £16 million in loss before tax for Prudential Capital from a loss of £45 million in 2015 to a loss of £29 million in 2016. These positive effects were partially offset by a decrease in the profit before tax for M&G of £8 million from £441 million in 2015 to £433 million in 2016 and a decrease of £15 million for US asset management from £11 million in 2015 to a loss of £4 million in 2016.

The £26 million increase in the profit before shareholder tax of Eastspring Investments in 2016 reflected the positive effect on average assets under management of favourable market movements and strong net inflows in the second half of the year.

The effective tax rate on profits from asset management operations remained at 17 per cent consistent with 2015.

Total profit from asset management decreased from £456 million in 2014 to £431 million in 2015. The decrease of £51 million in profit before shareholder tax in 2015 compared with 2014 resulted mainly from a decrease for Prudential Capital of £62 million from a profit of £17 million in 2014 to a loss of £45 million in 2015. Further, the M&G profit before shareholder tax decreased by £13 million. These decreases were partially offset by an increase in the profit before shareholder tax for Eastspring Investments of £25 million from £90 million to £115 million.

The £62 million decrease in the profit before shareholder tax of Prudential Capital in 2015 reflected a decrease of £23 million in operating profit based on longer-term investment returns and an adverse change in short-term fluctuations in investment returns of £39 million. During 2015, we started to refocus activity away from revenue generation towards internal treasury services.

The effective tax rate on profits from asset management operations decreased to 17 per cent in 2015 from 20 per cent in 2014, principally due to an increase in the proportion of income received which is not subject to tax or taxed at a concessionary rate and a reduction in the main rate of UK corporate tax that affects M&G and Prudential Capital.

# **Unallocated corporate result**

The following table shows the movement in the unallocated corporate result for the years indicated.

	Year	Year Ended 31 December £m		
	2016	2015	2014	
Loss before shareholder tax	(864)	(684)	(757)	
Shareholder tax credit	104	126	170	
Loss after tax	(760)	(558)	(587)	

Total net charges for unallocated corporate activity increased by £202 million from £558 million in 2015 to £760 million in 2016.

The loss before shareholder tax increased by £180 million from £684 million in 2015 to £864 million in 2016. Net other expenditure (including restructuring and Solvency II implementation costs) increased by £41 million from £675 million in 2015 to £716 million in 2016. Short-term fluctuations in investment returns increased by £139 million from a loss of £9 million in 2015 to a loss of £148 million in 2016, reflecting unrealised value movements on financial instruments.

The effective tax rate on unallocated corporate result decreased to 12 per cent in 2016 from 18 per cent in 2015 principally due to an increase in non-tax deductible expenses decreasing the tax credit on the unallocated corporate losses.

Total net charges for unallocated corporate activity decreased by £29 million from £587 million in 2014 to £558 million in 2015.

The loss before shareholder tax decreased by £73 million from £757 million in 2014 to £684 million in 2015. Net other expenditure (including restructuring and Solvency II implementation costs) increased by £14 million from £661 million in 2014 to £675 million in 2015. This was more than offset by a favourable change of £87 million in short-term fluctuations in investment returns from a loss of £96 million in 2014 to a loss of £9 million in 2015.

The effective tax credit on unallocated corporate result changed to 18 per cent in 2015 from 22 per cent in 2014, with 2014 benefiting from the release of provisions no longer required.

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### **Basis of performance measures**

Prudential uses a performance measure of operating profit based on longer-term investment returns. The directors believe that this performance measure better reflects underlying performance. It is the basis used by management for the reasons outlined below. It is also the basis on which analysis of the Group s results has been provided to UK shareholders and the UK financial market for some years under long standing conventions for reporting by proprietary UK life assurers.

Prudential determines and presents operating segments based on the information that is internally provided to the Group Executive Committee (GEC), which is Prudential s chief operating decision maker.

An operating segment is a component of Prudential that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of Prudential s other components. An operating segment s operating results are reviewed regularly by the GEC to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

The operating segments identified by Prudential reflect its organisational structure, which is by both geography (Asia, US and UK) and by product line (insurance operations and asset management).

The Group s operating segments, determined in accordance with IFRS 8 Operating Segments, are as follows:

### **Insurance operations:**

Asia US (Jackson) UK

### **Asset management operations:**

Eastspring Investments US broker-dealer and asset management M&G

#### Prudential Capital

The Group s operating segments are also its reportable segments for the purposes of internal management reporting.

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

Gain on the sale of the Group s stake in the PruHealth and PruProtect businesses in 2014;

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;

Loss attaching to the held for sale Korea life business. See note D1 for further details;

The recycling of the cumulative exchange translation loss on the sold Japan life business from other comprehensive income to the income statement in 2015; and

The costs associated with the domestication of the Hong Kong branch which became effective on 1 January 2014.

Segment results that are reported to the Group Executive Committee include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and the Asia Regional Head Office.

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

## (a) General principles

## (i) UK style with-profits business

The operating profit based on longer-term 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 operating profit.

## (ii) Unit-linked business

The policyholder unit liabilities are directly reflective of the underlying asset value movements. Accordingly, the operating results 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, with those of the general account, interest rate exposures. The principles for determination of the operating profit and short-term fluctuations are necessarily bespoke, 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 territories depending upon the nature of the grandfathered measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities is broadly equivalent in the income statement, and operating profit based on longer-term investments returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (ie after allocated investment return and charge for policyholder benefits) the operating result 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.

## (v) Other shareholder-financed business

The measurement of operating profit based on longer-term investment returns reflects the particular features of long-term insurance business where assets and liabilities are held for the long-term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance of life businesses exclusive of the effects of short-term fluctuations in market conditions. In determining the profit on this basis, the following key elements are applied to the results of the Group s shareholder-financed operations.

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) operating profit based on longer-term investment returns for shareholder-financed business is determined on the basis of expected longer-term investment returns.

Debt, equity-type securities and loans

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.

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 operating result is reflected in short-term fluctuations in investment returns; and

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

At 31 December 2016, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £969 million (2015: £567 million; 2014: £467 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 operations other than the UK annuity business, unit-linked and US variable annuity are of significance for the US and Asia insurance operations. Different rates apply to different categories of equity-type securities.

#### Derivative value movements

Generally, derivative value movements are excluded from operating results based on longer-term investment returns (unless those derivative value movements broadly offset changes in the accounting value of other assets and liabilities included in operating profit). The principal example of non-equity based derivatives (for example, interest rate swaps and swaptions) whose value movements are excluded from operating profit arises in Jackson, 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. For these products, the charge for policyholder benefits in the operating results should reflect the asset share feature rather than volatile movements that would otherwise be reflected if the local regulatory basis (also applied for IFRS basis) was used.

For certain other types of non-participating business, longer-term interest rates are used to determine the movement in policyholder liabilities for determining operating results.

# (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 being 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 operations amounted to £1,405 million as at 31 December 2016 (2015: £840 million; 2014: £932 million). The rates of return applied in 2016 ranged from 3.2 per cent to 13.9 per cent (2015: 3.5 per cent to 13.0 per cent; 2014: 2.7 per cent to 13.8 per cent) with the rates applied varying by territory. These rates are broadly stable from period to period but may

be different between countries reflecting, for example, differing expectations of inflation in each territory. The assumptions are for 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 operating results based on longer-term investment returns reflect the current period value movements in unit liabilities and the backing assets.

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## (ii) US variable and fixed index annuity business

The following value movements for Jackson s variable and fixed index annuity business are excluded from operating profit based on longer-term investment returns. See note B1.2 note (ii) to the consolidated financial statements in.:

Fair value movements for equity-based derivatives;

Fair value movements for embedded derivatives for the not for life portion of GMWB and fixed index annuity business, and GMIB reinsurance (see below);

Movements in the accounts carrying value of GMDB and the for life portion of GMWB and GMIB liabilities, for which, under the grandfathered US GAAP applied under IFRS for Jackson s insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements;

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.

Embedded derivatives for variable annuity guarantee minimum income benefit

The GMIB liability, which is essentially fully reinsured, subject to a deductible and annual claim limits, is accounted for in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 944-80 Financial Services Insurance Separate Accounts (formerly SOP 03-1) under IFRS using grandfathered US GAAP. As the corresponding reinsurance asset is net settled, it is considered to be a derivative under IAS 39, Financial Instruments: Recognition and Measurement , and the asset is therefore recognised at fair value. As the GMIB 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 operating profit, arises in Jackson. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson s bond portfolio (for which value movements are booked in the statement of comprehensive income rather than the income statement), product liabilities (for which US GAAP accounting as grandfathered under IFRS 4 does not fully reflect the economic features being hedged), and the interest rate exposure attaching to equity-based embedded derivatives.

# (iv) Other US shareholder-financed business *Debt securities*

Jackson is the shareholder-backed operation for which the distinction between impairment losses and interest-related realised gains and losses is in practice relevant to a significant extent. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) developed by external third parties such as BlackRock Solutions 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 to the consolidated financial statements in Item 18.

# Equity-type securities

As at 31 December 2016, the equity-type securities for US insurance non-separate account operations amounted to £1,323 million (2015: £1,004 million; 2014: £1,094 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:

	2016	2015	2014
Equity-type securities such as common and preferred stock and			
portfolio holdings in mutual funds	5.5% to 6.5%	5.7% to 6.4%	6.2% to 6.7%
Other equity-type securities such as investments in limited			
partnerships and private equity funds	7.5% to 8.5%	7.7% to 8.4%	8.2% to 8.7%

## (d) UK 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 operating results based on longer-term investment returns . Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

The operating result based on longer-term investment returns reflects the impact of value movements on policyholder liabilities for annuity business within the non-profit sub-fund of The Prudential Assurance Company (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 operating result, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

#### (ii) Non-linked shareholder-financed business

For debt securities backing non-linked shareholder-financed business of the UK 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. For these businesses, it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include realised gains and losses in the operating result with temporary unrealised gains and losses being included in short-term fluctuations. In some instances, it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying economic substance of the arrangements.

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# Analysis of operating profit based on longer-term investment returns

The following tables analyse Prudential s operating profit based on longer-term investment returns and Prudential s total profit after tax by business segment.

	Ins	urance ope	rations	2016 £m Asset management						
									Unallo-	
									cated	
									to a	
								S	segment	
				Prud	lential	Easts	spring	Total	(central	Group
	Asia	US	UK	M&G C	apital	InVSst	ments	segmente	rations)	total
Analysis of operating profit					•					
Operating profit (loss) based on longer-term	4.505		0.0							
investment returns	1,503	2,052	828	425	27	<b>(4)</b>	141	4,972	(716)	4,256
Short-term fluctuations in investment returns on shareholder-backed										
business	(225)	(1,455)	198	8	(56)	-	-	(1,530)	(148)	(1,678)
Amortisation of acquisition accounting adjustments	(8)	(68)	_	_	_	_	_	(76)	-	(76)
Loss attaching to the held for sale Korea life	(0)	(00)						(10)		(70)
business	(227)	-	-	-	-	-	-	(227)	-	(227)
Profit (loss) before tax attributable to shareholders	1,043	529	1,026	433	(29)	(4)	141	3,139	(864)	2 275
Tax attributable to	1,043	349	1,020	433	(29)	(4)	141	3,139	(004)	2,275
shareholders										(354)
Profit for the year										1,921
, , , , , , , , , , , , , , , , , , ,										,
	Ins	urance ope	rations	2015 £m (AER) Asset management						
	Asi		UK	M&Rru				g Total segment	Unallo-	Group

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**Capital Investments** 

total

cated

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to a

segment

(central

operations)

							ope	acions,	
1,171	1,691	1,195	442	19	11	115	4,644	(675)	3,969
(137)	(424)	(120)	(1)	(64)	-	-	(746)	(9)	(755)
(8)	(68)	-	-	-	-	-	(76)	-	(76)
56	-	-	-	-	-	-	56	-	56
(46)	-	-	-	-	-	-	(46)	-	(46)
1,036	1,199	1,075	441	(45)	11	115	3,832	(684)	3,148
									(569)
									2,579
	(8) 56 (46)	(137) (424) (8) (68) 56 - (46) -	(137) (424) (120) (8) (68) - 56 (46)	(137) (424) (120) (1) (8) (68) 56 (46)	(137)     (424)     (120)     (1)     (64)       (8)     (68)     -     -     -       56     -     -     -     -       (46)     -     -     -     -	(137) (424) (120) (1) (64) - (8) (68) 56 (46)	(137) (424) (120) (1) (64) (8) (68) (46)	1,171 1,691 1,195 442 19 11 115 4,644  (137) (424) (120) (1) (64) (746)  (8) (68) (76)  56 56  (46) (46)	(137)       (424)       (120)       (1)       (64)       -       -       (746)       (9)         (8)       (68)       -       -       -       -       -       (76)       -         56       -       -       -       -       -       56       -         (46)       -       -       -       -       -       (46)       -

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	Insura	ance ope	rations		2015 £m (CER) Asset management					
									Unallo-	
									cated	
									to a	
									segment	
				Pri	ıdential	East	spring	Total	(central	Group
	Asia	US	UK	M&G	Capital	<b>IdS</b> est	tments s		erations)	total
Analysis of operating profit										
Operating profit (loss) based on longer-term investment										
return	1,303	1,908	1,195	442	19	13	128	5,008	(675)	4,333
Short-term fluctuations in	1,505	1,,,00	1,170		17	10	120	2,000	(075)	1,000
investment returns on										
shareholder-backed business	(154)	(479)	(120)	(1)	(64)	-	-	(818)	(9)	(827)
Amortisation of acquisition										
accounting adjustments	(9)	(76)	-	-	-	-	-	(85)	-	(85)
Cumulative exchange loss on										
the sold Japan life business	(46)	-	-	-	-	-	-	(46)	-	(46)
Profit attaching to the held										
for sale Korea life business	62	-	-	-	-	-	-	62	-	62
Profit (loss) before tax										
attributable to shareholders	1,156	1,353	1,075	441	(45)	13	128	4,121	(684)	3,437
Tax attributable to										(601)
shareholders										(621)
Profit for the year										2,816

	Insura	nce oper	ations	2014 £m (AER) Asset management Unallo-	
				cated	
				to a	
				segment Total	
				Prudential Eastspring segment (central Group	
	Asia	US	UK	M&G Capital Investments note (inperations) total	
Analysis of operating profit					

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Operating profit based on										
longer-term investment										
returns	1,018	1,431	776	446	42	12	90	3,815	(661)	3,154
Short-term fluctuations in										
investment returns on										
shareholder-backed business	147	(1,103)	464	8	(25)	-	-	(509)	(96)	(605)
Amortisation of acquisition										
accounting adjustments	(8)	(71)	-	-	-	-	-	(79)	-	(79)
Cumulative exchange loss										
on the sold Japan life										
business	-	-	86	-	-	-	-	86	-	86
Profit attaching to the held										
for sale Korea life business	63	-	-	-	-	-	-	63	-	63
Costs of domestication of										
Hong Kong branch	-	-	(5)	-	-	-	-	(5)	-	(5)
Profit (loss) before tax										
attributable to shareholders	1,220	257	1,321	454	17	12	90	3,371	(757)	2,614
Tax attributable to										
shareholders										(398)
Profit for the year										2,216

Profit for the year

		Inc	urance	20	14 £m (	(CER)				
			rations		Asset management				Unallo-	
									cated	
									to a	
								Total	segment	
				Pru	dential	Easts	pring	segment	(central	Group
	Asia	US	UK	M&G (	Capital	Inly Sst	ments	note (iöp	erations)	total
Analysis of operating profit					_					
Operating profit (loss) based										
on longer-term investment return	1,008	1,543	776	446	42	13	91	3,919	(661)	3,258
Short-term fluctuations in	1,000	1,545	770	770	7∠	13	71	3,717	(001)	3,230
investment returns on										
shareholder-backed business	157	(1,189)	464	8	(25)	-	-	(585)	(96)	(681)
Amortisation of acquisition	(0)	(7.6)						(05)		(0.5)
accounting adjustments Cumulative exchange loss	(9)	(76)	-	-	-	-	-	(85)	-	(85)
on the sold Japan life										
business	_	_	86	_	_	_	_	86	_	86
Profit attaching to the held										
for sale Korea life business	63	-	-	-	-	-	-	63	-	63
Costs of domestication of										
Hong Kong branch	-	-	(5)	-	-	-	-	(5)	-	(5)
Profit (loss) before tax	4.040	250	4 224				0.4	2 202	/= -= \	2 (2 (
attributable to shareholders	1,219	278	1,321	454	17	13	91	3,393-	(757)	2,636
Tax attributable to shareholders										(396)
SHAICHUIUCIS										(330)

2,240

<sup>\*</sup> For 2015, the CER results were calculated using the 2016 average exchange rates.

<sup>\*\*</sup> For 2014, the CER results were calculated using the 2015 average exchange rates.

<sup>\*\*\*</sup> Includes the results of the sold PruHealth and PruProtect businesses (£23 million for 2014 and £11 million for 2013).

# Explanation of performance and other financial measures

## **IFRS Profit**

				Constant	Evobongo		Constant
	A ctual	Exchange	Rata	Rat	_	Exchange Rate	Rate**
	2016 £m 2	_		2015 £mCl		2014 £m 2	
Operating profit before tax based on	2010 21112		iange /e	2015 2116	nunge /e	2014 2011 2	2014 2111
longer-term investment returns(i)							
Long-term business(ii):							
Asia***	1,503	1,171	28	1,303	15	1,018	1,008
US	2,052	1,691	21	1,908	8	1,431	1,543
UK	799	1,167	(32)	1,167	(32)	729	729
Long-term business operating profit***	4,354	4,029	8	4,378	(1)	3,210	3,280
UK general insurance commission	29	28	4	28	4	24	24
Asset management business:							
M&G	425	442	(4)	442	(4)	446	446
Prudential Capital	27	19	42	19	42	42	42
Eastspring Investments	141	115	23	128	10	90	91
US	(4)	11	(136)	13	(131)	12	13
Other income and expenditure	<b>(716)</b>	(675)	(6)	(675)	(6)	(638)	(638)
Total operating profit based on							
longer-term investment returns before							
tax***	4,256	3,969	7	4,333	(2)	3,154	3,258
Non-operating items:							
Short-term fluctuations in investment							
returns on shareholder-backed business(iii)	(1,678)	(755)	122	(827)	103	(605)	(681)
Amortisation of acquisition accounting							
adjustments	<b>(76)</b>	(76)	n/a	(85)	n/a	(79)	(85)
(Loss)/Profit attaching to held for sale							
Korea business***	(227)	56	n/a	62	n/a	63	63
Cumulative exchange loss on the sold Japan							
life business recycled from other							
comprehensive income	-	(46)	n/a	(46)	n/a	-	-
Gain on sale of PruProtect and PruHealth	-	-	n/a	-	n/a	86	86
Cost of domestication of Hong Kong branch	-	-	n/a	-	n/a	(5)	(5)
Profit before tax attributable to							
shareholders	2,275	3,148	(28)	3,437	(34)	2,614	2,636
Tax charge attributable to shareholders							
returns	(354)	(569)	38	(621)	43	(398)	(396)
Profit for the year attributable to							
shareholders	1,921	2,579	(26)	2,816	(32)	2,216	2,240

<sup>\*</sup> For 2015, the CER results were calculated using the 2016 average exchange rates.

\*\*\*

<sup>\*\*</sup> For 2014, the CER results were calculated using the 2015 average exchange rates.

Following its reclassification to held for sale during 2016, operating results exclude the results of the Korea Life business. The 2015 and 2014 comparative results have been retrospectively adjusted on a comparable basis.

#### **Notes**

- (i) The Group provides supplementary analysis of IFRS profit before tax attributable to shareholders so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. Operating profit based on longer-term investment returns is the basis on which management regularly reviews the performance of Prudential s segments as defined by IFRS 8. Further discussion on the determination of operating profit based on longer-term investment returns is provided in B1.3 to the consolidated financial statements and section Basis of performance measures above.
- (ii) The results of the Group s long-term business operations are affected by changes to assumptions, estimates and bases of preparation. Where applicable, these are described in note B4 to the consolidated financial statements.
- (iii) Short-term fluctuations in investment returns on shareholder-backed business comprise:

	Ac	tual Exchange	Rate
	2016 £m	2015* £m	2014* £m
Insurance operations:			
Asia	(225)	(137)	147
US	(1,455)	(424)	(1,103)
UK	198	(120)	464
Other operations	(196)	(74)	(113)
Total	(1,678)	(755)	(605)

<sup>\*</sup> To facilitate comparisons of operating profit based on longer-term investment returns that reflect the Group's retained operations, the short-term fluctuations in investment returns attributable to the held for sale Korea life business are included separately within the supplementary analysis of profit.

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Further details on the short-term fluctuations in investment returns are provided below under Short-term fluctuations in investment returns and also in note B1.2 in the consolidated financial statements.

## Earnings per share

Actual

exchange

	Actual exchange rate			Constant exc	rate	
	2016 2015			2015	Change	2014
	pence	pence	Change %	pence	Change %	pence
Basic earnings per share based on						
operating profit after tax*	131.3	124.6	5	136.0	(3)	95.7
Basic earnings per share based on total						
profit after tax	<b>75.0</b>	101.0	(26)	110.1	(32)	86.9

<sup>\*</sup>Following its reclassification to held for sale during 2016, operating results exclude the results of the Korea life business. The 2015 and 2014 comparative results have been similarly adjusted.

Prudential s financial performance in 2016 has showcased the resilience of our earnings, cash and capital. While these are qualities mentioned in previous reports, the external events of 2016 have seen them tested repeatedly across our businesses during a year of significant uncertainty, market volatility and unexpected political and regulatory events. By remaining focused on our strategy and on disciplined execution, our business withstood the effect of these events and successfully adapted to changes in market conditions, regulatory intervention and shifts in consumer preference, to deliver a strong operating performance in 2016 and an improved capital position.

Prudential s financial attributes and multiple, diverse levers of growth have enabled the Group to absorb not only the areas of earnings pressure known at the beginning of the year, but also the fluctuations of both equity markets and yields. New business profit, IFRS operating profit based on longer-term investment returns and free surplus generation, the three financial measures that we use to track delivery of our growth and cash agenda, have all increased in 2016 when expressed on an actual exchange rate basis. This achievement demonstrates the benefits of our scale and the strength of our business model which is well diversified by geography, currency and source of earnings. The 2016 results also highlight the earnings power of our growing in-force book of business and our ability to add large new business volumes which are an important store of future value. The year-on-year trends of the three—growth and cash—measures are also positive when expressed on a constant exchange rate basis, except for operating profit based on longer-term investment returns, where we have seen a marginal fall due to the effect of one-off impacts in our UK Life operations.

The Group s performance has once-again been led by Asia, with growth across the three growth and cash measures for the seventh year in a row. This underlines the scale and quality of our regional franchise, characterised by the high proportion of recurring income and bias for protection business that is uncoupled from market effects. In our insurance and asset management businesses in the UK and US, we have continued to build our earnings base with growth in assets managed on behalf of our customers.

2016 has seen sterling weakening against most global currencies, which is positive for the translation of results from our sizeable non-sterling operations. However, to aid understanding of the underlying progress in these businesses, we

continue to express and comment on the performance trends of our Asia and US operations on a constant currency basis.

Consistent with the explanations made in the currency volatility section in the Summary of Operating and Financial Review and Prospects comparison of the 2016 and 2015 performance is partially affected by the movements in average exchange rates used to translate into sterling the results of our overseas operations. Therefore, to facilitate explanations of changes in underlying performance, in the commentary on 2016 compared with 2015 (and also, 2015 compared with 2014) discussions below, every time we comment on the performance of our businesses, we focus on their performance measured on the constant exchange rates basis unless otherwise stated. In each such case, the performance of our businesses in actual exchange rate terms was explained by the same factors discussed in the comments below and the impact of currency movements implicit in the CER data.

The 2015 compared with 2014 discussions provided below are on a constant exchange rate basis, and the 2014 CER numbers have been computed by applying 2015 average rates of exchange to the 2014 income and rates of

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exchange on 31 December 2015 to the balance sheet at 31 December 2014. These comparative discussions were on the basis as published in the 2015 20-F and reflected how management reviewed the results at that time.

The key financial highlights in 2016 were as follows:

Operating profit based on longer-term investment returns was 2 per cent<sup>1</sup> lower at £4,256 million (up 7 per cent on an actual exchange rate basis). Operating profit from our Asia life insurance and asset management businesses grew by 15 per cent to £1,644 million (up 28 per cent on an AER basis) reflecting continued business momentum. In the US, Jackson s total operating profit increased by 7 per cent (20 per cent on an AER basis), mainly due to growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread earnings. In the UK, total operating profit was 31 per cent lower than the prior year, as a result of significantly reduced profits from annuity new business, following our withdrawal from the bulk annuity market, the lower contribution from actions to support solvency and a provision for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress. M&G s operating profit was 4 per cent lower, reflecting the earnings impact of the recent period of net fund outflows, Group shareholders Solvency II capital surplus was estimated at £12.5 billion at 31 December 2016, equivalent to a cover ratio of 201 per cent<sup>3</sup> (1 January 2016: £9.7 billion, 193 per cent). The improvement in the period primarily reflects the continuing strength of the Group's operating capital generation in excess of growing dividend payments to shareholders, and also includes the benefit of debt issued in the year. Full year ordinary dividend increased by 12 per cent to 43.5 pence per share, reflecting our strong 2016 performance and our confidence in the future prospects of our Group.

Global investment market movements during 2016 were dominated by the sharp drop in long-term yields over the first three quarters, and the subsequent recovery into the end of the year prompted by more favourable growth expectations in the US. Equity market performance was notably stronger in the second half of the year, contributing to a generally positive movement for 2016 overall in the countries in which we operate. Over the full year, the US S&P 500 index was up 10 per cent, the UK FTSE 100 index up 12 per cent and the MSCI Asia ex-Japan index up 5 per cent. We have taken steps to reduce the investment market sensitivity of our earnings and balance sheet, but remain significant long-term holders of financial assets to back the commitments that we have made to our customers. Short-term fluctuations in both these assets and related liabilities are reported outside the operating result, which is based on long-term investment return assumptions. These short-term fluctuations were overall negative in 2016, primarily as a result of movements in the value of derivatives used by Jackson to protect the economics of its business from adverse market shocks. As a result, total IFRS post tax profit was £1,921 million (2015: £2,579 million on an actual exchange rate basis).

Reflecting the combined effects of improved operating results on an actual exchange rate basis, negative short-term investment fluctuations and positive currency movements of £1.2 billion, IFRS shareholders equity was 13 per cent higher at £14.7 billion. As at 31 December 2016, the Group s Solvency II capital surpluswas £12.5 billion, equivalent to a cover ratio of 201 per cent<sup>3</sup> (1 January 2016: £9.7 billion, 193 per cent).

#### Operating profit based on longer-term investment returns

Total operating profit based on longer-term investment returns declined by 2 per cent<sup>1</sup> (7 per cent increase on an actual exchange rate basis) in 2016 to £4,256 million, with increases in Asia and the US offset by anticipated declines in the contribution from our UK businesses.

Asia total operating profit of £1,644 million was 15 per cent<sup>1</sup> higher than the previous year (28 per cent on an actual exchange rate basis), with strong growth in both life insurance and asset management through Eastspring Investments.

US total operating profit at £2,048 million increased by 7 per cent (20 per cent increase on an actual exchange rate basis), driven by higher fee income from growth in Jackson s separate account asset base and lower amortisation of deferred acquisition costs, which together exceeded the anticipated reduction in spread income.

UK total operating profit was 31 per cent lower at £828 million. This decline reflects lower profit from new annuity business, down from £123 million to £41 million in 2016, as we scale down our participation in the

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annuity market, a lower contribution from management actions to support solvency, down from £400 million to £332 million, and the establishment of a £175 million provision for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress.

M&G operating profit was 4 per cent lower at £425 million. The impact of recent asset outflows from retail funds on overall funds under management has been partially offset by the benefit of positive market movements.

At the beginning of the year, we expected that earnings would contract in a few discrete areas of the business: at M&G, due to the impact of outflows on funds under management and the corresponding fee income; in Jackson s spread business portfolio as a result of persistently low interest rates; and in our UK life business given our withdrawal from the bulk annuity market. These identified effects have emerged largely as expected. However, our focus on cost control and the effective management of our in-force book of business have mitigated the overall impact of these anticipated adverse effects. Earnings have also benefited from continued growth in the premium base in Asia and the level of aggregate assets managed by our life and asset management operations across the Group, which together underpin the longer-term earnings progression of our business.

## **Insurance Operations**

## 2016 compared with 2015 (CER)

## Life insurance operations

Taken together, operating profit from our life insurance operations in Asia, the US and the UK was 1 per cent¹ lower at £4,354 million (8 per cent increase on an actual exchange rate basis).

Operating profit in our life insurance operations in **Asia** was 15 per cent<sup>1</sup> higher at £1,503 million (up 28 per cent on an actual exchange rate basis), reflecting our ability to translate top line growth into shareholder value. The performance is underpinned by the recurring premium income nature of our in-force book and the highly diverse nature of our earnings by geography and by source. Insurance income was up 24 per cent (38 per cent on an actual exchange rate basis), reflecting our continued focus on health and protection business. At a country level, we have seen double-digit growth in six markets, led by Hong Kong (up 40 per cent, and 59 per cent on an AER basis), China (up 83 per cent, and 100 per cent on an AER basis) and growth of 15 per cent or more (20 per cent or more on an AER basis) from Malaysia, Thailand, Vietnam and Taiwan. These markets have more than compensated for the impact of lower earnings growth in Indonesia and Singapore, following deliberate actions taken to improve the quality of new business flows.

In the **US**, life operating profit was 8 per cent higher at £2,052 million (up 21 per cent on an actual exchange rate basis), reflecting the resilient performance of Jackson s franchise in an environment of market volatility and sector wide disruption following the announcement of the Department of Labor s fiduciary duty rule in April 2016. Average separate account balances increased by 5 per cent (17 per cent on an AER basis), resulting in a 3 per cent rise in fee income (16 per cent on an AER basis), while the result also benefited from scale efficiencies. As expected, lower yields in the year have impacted spread income, which decreased by 5 per cent (increased by 8 per cent on an AER basis).

**UK** life operating profit declined by 32 per cent to £799 million (2015: £1,167 million). Within this total, the contribution from our core in-force with-profits and annuity business was £601 million (2015: £644 million), including an unchanged transfer to shareholders from the with-profits funds of £269 million. The balance of the result reflects the contribution from other activities which are either non-core or are not expected to recur to the same extent going forward.

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Profit from new annuity business reduced from £123 million in 2015 to £41 million, as we scaled down our participation in the annuity market. In response to the volatile investment market environment during 2016, we took a number of asset and liability actions to improve the solvency position of our UK life operations and further mitigate market risk, generating combined profits of £332 million (2015: £400 million). Of this amount, £197 million related to profit from longevity reinsurance transactions (2015: £231 million) and £135 million (2015: £169 million) from the effect of repositioning the fixed income asset portfolio. In response to the findings of the FCA s thematic review of non-advised annuity sales practices, the UK business will review internally vesting annuities sold without advice after 1 July 2008. Reflecting this, the UK life 2016 result includes a provision of £175 million for the cost of this review and related potential redress. The provision does not include potential insurance recoveries of up to £175 million.

We track the progress that we make in growing our life insurance business by reference to the scale of our obligations to our customers, which are referred to in the financial statements as policyholder liabilities. Each year these increase as we write new business and collect regular premiums from existing customers and decrease as we pay claims and policies mature. The overall scale of these policyholder liabilities is relevant in the evaluation of our profit potential in that it reflects, for example, our ability to earn fees on the unit-linked element and indicates the scale of the insurance element, another key source of profitability for the Group.

Refer to section I(a) within the Additional unaudited financial information for further information on operating profit based on longer-term investment returns by driver.

## 2015 (AER) vs 2014 (CER based on 2015 exchange rates)

Taken together, operating profit based on longer-term investment returns from our insurance operations in Asia, the US and the UK increased 23 per cent<sup>4</sup> to £4,095 million (27 per cent on an AER basis). This increase reflects the growth in the scale of these operations, driven primarily by positive business inflows. We track the progress that we make in growing our life insurance business by reference to the scale of our obligations to our customers, which are referred to in the financial statements as policyholder liabilities. Each year these liabilities increase as we collect premiums and decrease as we pay claims and policies mature. The overall scale of these policyholder liabilities is relevant in evaluating our profit potential, in that it reflects, for example, our ability to earn fees on the unit-linked element and it sizes the risk that we carry on the insurance element, for which Prudential needs to be compensated.

Operating profit based on longer-term investment returns from our portfolio of life insurance operations in Asia was up 16 per cent to £1,209 million (15 per cent on an AER basis), driven by a 14 per cent increase in the contribution from the in-force business, reflecting both its larger scale and our regular premium health and protection oriented product focus. Indonesia operating profit based on longer-term investment returns, our largest market on this measure, increased 21 per cent to £356 million (15 per cent on an AER basis), reflecting the addition of new savings and protection sales in the year to an already sizeable recurring premium in-force business. Hong Kong operating profit based on longer-term investment returns was 27 per cent higher at £150 million (38 per cent on an AER basis), mainly due to the increasing profit contribution from a growing customer base purchasing health and protection cover. Malaysia operating profit based on longer-term investment returns grew by 12 per cent to £120 million (2 per cent on an AER basis), reflecting a growing contribution from the in-force business. Operating profit based on longer-term investment returns in Singapore declined 4 per cent to £204 million (5 per cent on an AER basis), the result of our deliberate decision to discontinue universal life sales as the returns of these products in the current interest rate environment are unattractive. We are also encouraged to see further progress among our fast-growing businesses in China, Thailand, the Philippines and Vietnam which collectively generated £220 million of Asia s operating profit based on longer-term investment returns, up 28 per cent compared with the prior year (33 per cent on an AER basis) and now account for 18 per cent of the total life result compared with just 7 per cent only 3 years ago.

In the US, operating profit based on longer-term investment returns increased by 10 per cent to £1,691 million (18 per cent on an AER basis), primarily as a result of an 11 per cent increase in fee income, which is now Jackson s main income source, and efficient management of costs. The uplift in fee income reflects the growth in average separate account assets from £78.1 billion in 2014 to £86.9 billion in 2015, equating to an increase of 11 per cent on a constant exchange rate basis (20 per cent on an AER basis), driven by sizeable variable annuity net premium inflows. Contribution from insurance margin also increased by 10 per cent. Lower yields impacted the spread income which decreased by 6 per cent on a constant exchange rate basis.

UK insurance operations—operating profit based on longer-term investment returns was 60 per cent higher than 2014 at £1,195 million (2014: £753 million<sup>4</sup>) with general insurance commissions increasing to £28 million (2014: £24 million). New annuity business contributed £123 million (2014: £162 million) including £89 million (2014: £105 million) from the four bulk transactions completed in 2015. The balance of £1,044 million (2014: £567 million) reflects a robust level of profit from our core annuity in-force and with-profits business and includes a £339 million benefit from specific management actions taken in the second half of the year to position the balance sheet more efficiently under the new Solvency II regime. Of this amount, £170 million related to profit on longevity reinsurance transactions executed in the second half of the year, with a further £169 million reflecting the effect of repositioning the fixed income asset portfolio and other actions. The non-recurring nature of these actions and our reduced appetite for annuities post-Solvency II will mean that, going forward, IFRS earnings from our UK life business will be predominantly driven by the contribution from core annuity in-force and with-profits business.

Shareholder-backed policyholder liabilities and net liability flows\*

		2016 Actual Excl				2015 Actual Excl	nange Rate	
	At	Ma	arket and	A 4	At		Market and	At
	1 JanuaryNe	et liability	other 31	At December	1 January N	et liability	other31	December
	2016	flows** m		2016	2015	flows**mo	vements	2015
Asia****	25,032	2,086	5,733	32,851	26,410	1,867	(433)	27,844
US	138,913	5,198	33,515	177,626	126,746	8,476	3,691	138,913
UK	52,824	(3,646)	6,980	56,158	55,009	(2,694)	509	52,824
Total Group	216,769	3,638	46,228	266,635	208,165	7,649	3,767	219,581

- \* Includes Group s proportionate share of the liabilities and associated flows of the insurance joint ventures and associates in Asia.
- \*\* Defined as movements in policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.
- \*\*\*Following its reclassification to held-for-sale during 2016, the shareholder-backed policyholder liabilities for Asia exclude the value of policyholder liabilities held at 1 January 2016 and 2016 net liability flows for Korea life business.

Focusing on the business supported by shareholder capital, which generates over 90 per cent of the life profit, in 2016 net flows into our businesses were overall positive at £3.6 billion, reflecting our focus on both retaining our existing customers and attracting new business to drive long-term value creation. The weakening of sterling during the year contributed a total £32.4 billion positive foreign exchange movement which, together with favourable investment and other movements, led to a £46.2 billion increase in policyholder liabilities, with much of this arising in the second half of the year.

Policyholder liabilities and net liability flows in with-profits business\*,\*\*

2016 £m Actual Exchange Rate 2015 £m Actual Exchange Rate

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			Market				Market			
	20,934 3,696 100,069 1,119		and		At	At and				
	At			At				At		
	1 JanuaryNo	et liability	other31	December	1 JanuaryNo	et liability	other3	1 December		
	2016	flows*** m	ovements	2016	2015	flows***m	ovements	2015		
Asia	20,934	3,696	5,303	29,933	18,612	2,102	220	20,934		
UK	100,069	1,119	11,958	113,146	99,427	(968)	1,610	100,069		
Total Group	121,003	4,815	17,261	143,079	118,039	1,134	1,830	121,003		

<sup>\*</sup> Includes Group s proportionate share of the liabilities and associated flows of the insurance joint ventures and associates in Asia.

The 18 per cent increase in policyholder liabilities in our with-profits business to £143.1 billion (2015: £121.0 billion), reflects the growing popularity with consumers seeking protection from the impact of volatile market conditions. In the course of 2016, net liability flows increased to £4.8 billion across our Asian and UK operations. As returns from these funds are smoothed and shared with customers, the emergence of shareholder profit is more gradual. This business, nevertheless, remains an important source of future shareholder value.

<sup>\*\*</sup> Includes Unallocated surplus of with-profits business

<sup>\*\*\*</sup> Defined as movements in policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.

Analysis of long-term insurance business pre-tax operating profit based on longer-term investment returns by

		Actual Exchange Rate 2016 £m 2015 £m					Constant Exchange Rate 2015 £m				Actual Exchange Rate 2014 £m		
0			MarginO <sub>2</sub>			Margin (	Operating		MarginO			Margin	
	profit <sup>1</sup>	liability	bps	profit <sup>1</sup>	liability	bps	profit <sup>1</sup>	liability	bps	profit <sup>1</sup>	liability	bps	
pread income	-	83,054	141	1,153	72,900	158	1,267	78,026	162	1,129	66,680	169	
ee income	2,175	139,451	156	1,888	123,232	153	2,118	135,717	156	1,610	108,949	148	
Vith-profits	317	118,334	27	314	106,749	29	319	108,551	29	298	101,290	29	
nsurance nargin	1,991			1,671			1,858			1,393			
Margin on evenues	2,126			1,822			2,000			1,634			
Expenses:	,												
osts	(2,251)	6,320	(36)%	(2,100)	5,466	(38)%	(2,339)	5,995	(39)%	(1,947)	4,514	(43)%	
Administration xpenses*	. , , ,	229,477	(85)	(1,656)	203,664	(81)	(1,829)	222,250	(82)	(1,422)	183,471	(77)	
DAC	(19773)	, <del>-</del> 1	(03)	(1,050)	203,004	(01)	(1,027)	222,230	(02)	(1,722)	103,7/1	(11)	
djustments	390			313			352			269			
Expected eturn on hareholder							002			207			
ssets	221			224			232			214			
	4,197			3,629			3,978			3,178			
congevity einsurance nd other nanagement ctions to mprove UK olvency	332			400			400						
rovision for	334			400			400			_			
eview of past	(175)												
nnuity sales Operating rofit based on onger-term nvestment										_			
eturns <sup>1</sup>	4,354			4,029			4,378			3,178		]	

<sup>\*</sup>The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. The acquisition costs include only those relating to shareholders backed business.

Alongside growing our overall level of life operating profit, we continue to maintain our bias for higher-quality sources of income such as insurance margin and fee income. We favour insurance margin because it is relatively

insensitive to the equity and interest rate cycle and prefer fee income to spread income because it is more capital-efficient. In line with this approach, on a constant exchange rate basis, insurance margin has increased by 7 per cent (up 19 per cent on an actual exchange rate basis) and fee income by 3 per cent (up 15 per cent on an actual exchange rate basis), while spread income decreased by 8 per cent (up 2 per cent on an actual exchange rate basis).

## Asset management

Movements in asset management operating profit are also primarily influenced by changes in the scale of these businesses, as measured by funds managed on behalf of external institutional and retail customers and our internal life insurance operations. In 2016, operating profit from our asset management businesses was marginally lower at £589 million on an actual exchange rate basis (2015: £602 million on a constant exchange rate basis), primarily due to the impact of negative net flows in M&G.

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Asset management net inflows and external funds under management\*, \*\*

		2016	£m		2015 £m				
	A	ctual Excl	nange Rat	e	Actual Exchange Rate				
	Market				Market				
	At		and	At	At		and	At	
	1 January		other	31 Dec	1 January		other	31 Dec	
	<b>2016</b> I	Net flownso	vements	2016	2015 N	2015			
M&G	126,405	(8,090)	18,448	136,763	137,047	(7,008)	(3,634)	126,405	
Eastspring***	30,281	1,835	5,926	38,042	25,333	5,971	(1,023)	30,281	
Total external assets managed	156,686	(6,255)	24,374	174,805	162,380	(1,037)	(4,657)	156,686	
Total external assets managed									
(including MMF)	162,692	(5,852)	25,679	182,519	167,180	28	(4,516)	162,692	

<sup>\*</sup>Includes Group s proportionate share in PPM South Africa and the Asia asset management joint ventures.

# 2016 compared with 2015 (CER)

**M&G** s operating profit based on longer-term investment returns declined by 4 per cent to £425 million (2015: £442 million), reflecting the impact on revenues of lower average assets under management during the year, following the net outflows experienced since the second quarter of 2015. As these net outflows were primarily from the higher margin retail business, they had a disproportionately adverse impact on earnings. The same dynamics have seen the cost-income ratio move up 2 percentage points to 59 per cent.

Despite continued outflows in 2016, external assets under management at 31 December 2016 were 8 per cent higher than a year ago at £136.8 billion, benefitting from positive investment market movements, particularly in the second half of the year and a return to positive net flows for retail business in the fourth quarter of £942 million. Including the assets managed for internal life operations, M&G s total assets under management rose to £264.9 billion (2015: £246.1 billion).

Our Asia-based asset manager, Eastspring Investments, increased operating profit based on longer-term investment returns by 10 per cent (up 23 per cent on an actual exchange rate basis) to £141 million, reflecting the positive effect on average assets under management of favourable market movements and £2.2 billion net inflows in the second half of the year. Although a shift in the mix of assets away from higher-margin equity funds has moderated the overall revenue margin, scale efficiencies have resulted in an improvement in the cost-income ratio to 56 per cent (2015: 58 per cent). External assets under management at 31 December 2016 increased to £38.0 billion (31 December 2015: £30.3 billion). Including money market funds and the assets managed for internal life operations, Eastspring Investment s total assets under management rose to a record £117.9 billion (2015: £89.1 billion).

## 2015 (AER) vs 2014 (CER based on 2015 exchange rates)

<sup>\*\*</sup> For our asset management business the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(a) of the Additional unaudited financial information.

<sup>\*\*\*</sup>Netinflows exclude Asia Money Market Fund (MMF) inflows of £403 million (2015: net inflows £1,065 million). External funds under management exclude Asia MMF balances of £7,714 million (2015: £6,006 million).

In 2015, our asset management businesses in the UK and Asia collectively increased their contribution to operating profit based on longer-term investment returns compared with the previous year. Similar to the trend observed in our life operations, asset management operating profit primarily reflects the scale of these businesses, as measured by funds managed on behalf of external institutional and retail customers and our internal life insurance operations.

M&G delivered a broadly unchanged operating profit based on longer-term investment returns of £442 million (2014: £446 million), reflecting a 2 per cent rise in underlying profit to £406 million (2014: £400 million), lower

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performance-related fees of £22 million (2014: £33 million) and a similar level of earnings from associates of £14 million (2014: £13 million). While underlying revenues in the first half of 2015 benefited from higher levels of funds under management, the large net outflows from retail funds since May contributed to a 2 per cent decrease in underlying revenues for the year overall. Actions on costs mitigated the effect of lower overall revenues to deliver a modest increase in underlying profit compared with 2014. However, the lower level of assets under management at the end of 2015 will impact the revenue prospects for 2016 absent a meaningful recovery in M&G s overall third-party net flows or a significant uplift in the market value of assets.

Our Asia asset management business, Eastspring Investments, has benefited from significant growth in funds under management during 2015, with operating profit based on longer-term investment returns higher by 26 per cent (28 per cent on an AER basis) at £115 million. An 11 per cent increase in third party net inflows to £6.0 billion saw external funds managed rise by 20 per cent on an actual exchange rate basis to £30.3 billion at end-2015. Average total funds under management, including funds managed on behalf of Prudential s life operations, increased by 25 per cent to £85.1 billion compared with 2014. Eastspring Investments growth in fee revenue outpaced the increase in operating costs, resulting in a modestly improved cost income ratio of 58 per cent (59 per cent on an actual exchange rate basis).

In the US, our non-insurance businesses collectively generated operating profit based on longer-term investment returns of £11 million (2014: CER basis £13 million; AER basis £12 million). In July, Jackson announced that Curian would no longer accept new business effective from 31 July 2015. Curian continues to actively manage existing accounts into 2016 to allow for the transition of accounts, but is expected to exit the business around the end of the first quarter of 2016. Total operating losses in Curian in 2015 were £16 million and included £13 million of cost related to exiting the business.

Prudential Capital produced operating profit based on longer-term investment returns of £19 million in 2015 (2014: £42 million). During 2015 we started to refocus activity away from revenue generation towards internal treasury services and this reprioritisation will continue into 2016.

## Non-operating items<sup>5</sup>

Non-operating items consist of short-term fluctuations, the results attaching to the held for sale life business in Korea and other non-operating items.

Short-term investment fluctuations represent the most significant component of non-operating items and are discussed further below.

The result of the held for sale Korea life business, a loss of £227 million, comprises both the write down of the IFRS net assets to sales proceeds (net of costs) and the profits for the year. The comparative profits for the year have been similarly reclassified as non-operating for consistency of presentation.

Other non-operating items of negative £76 million mainly represent the amortisation of acquisition accounting adjustments arising principally on the acquisition of the REALIC business in 2012 (2015: negative £76 million on an actual exchange rate basis). Additionally, 2015 non-operating items included a loss of £46 million from the recycling of exchange losses on the sale of the Japan business.

#### **Short-term fluctuations in investment returns**

Operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term

fluctuations in investment returns. In 2016, the total short-term fluctuations in investment returns relating to the life operations were negative £1,482 million and comprised negative £225 million for Asia, negative £1,455 million in the US and positive £198 million in the UK.

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The Asia negative £225 million short-term fluctuations principally reflected the net impact of changes in interest rates and equity markets across the region.

In the US, Jackson provides certain guarantees on its annuity products, the value of which would typically rise when equity markets fall and long-term interest rates decline. Jackson charges fees for these guarantees which are in turn used to purchase downside protection in the form of options and futures to mitigate the effect of equity market falls, and swaps and swaptions to cushion the impact of drops in long-term interest rates. Under IFRS, accounting for the movement in the valuation of these derivatives, which are all fair valued, is asymmetrical to the movement in guarantee liabilities, which are not fair valued in all cases. Jackson designs its hedge programme to protect the economics of the business from large movements in investment markets and accepts the variability in accounting results. The negative short-term fluctuations of £1,455 million in the year mainly reflect the effect of the increase in equity markets on net value movements on the guarantees and associated derivatives with the S&P 500 index closing at 10 per cent higher than at the start of the year. While the resulting negative mark-to-market movements on these hedging instruments are recorded in 2016, the related increases in fee income that arise from the higher asset values managed, will be recognised and reported in future years.

The UK non-operating profit of positive £198 million mainly reflects gains on bonds backing annuity capital and shareholders funds following the 70 basis points fall in 15-year UK gilt yields in 2016.

The negative short-term fluctuations in investment returns for other operations of negative £196 million (2015: negative £61 million) include unrealised value movements on financial instruments.

In 2015, the total short-term investment fluctuations relating to the life operations were negative £663 million, comprising negative £119 million for Asia, negative £424 million in the US and negative £120 million in the UK.

In Asia, the negative short-term fluctuations of £119 million reflected net unrealised losses on fixed income securities, primarily due to rises in bond yields.

Short-term fluctuations in the US mainly reflect the net value movement on the guarantees offered by Jackson and the associated derivatives held to manage market exposures. Under IFRS accounting the movement in the valuation of derivatives, which are fair valued, is asymmetrical to the movement in the guarantee liabilities, which are not fair valued in all cases. Jackson designs its hedge programme to protect the economics of the business from large movements in investment markets and therefore accepts variability in the accounting results. The negative short-term fluctuations of £424 million in 2015 were primarily attributable to the net value movement in the year of the hedge instruments held to manage market exposures.

Negative short-term fluctuations of £120 million in the UK reflected net unrealised losses on fixed income assets supporting the excess capital held within the shareholder-backed annuity business following a rise in interest rates during the year.

In 2014 the total short-term investment fluctuations relating to the life operations were negative £461 million, comprising positive £178 million for Asia, negative £1,103 million in the US and positive £464 million in the UK.

In Asia, the positive short-term fluctuations of £178 million in 2014 primarily reflected net unrealised gains on fixed income securities following falls in bond yields across the region during the year.

Negative short-term fluctuations of £1,103 million in the US in 2014 mainly reflected the net value movement on the guarantees offered by Jackson and the associated derivatives held to manage market exposures. Under IFRS

accounting the movement in the valuation of derivatives, which are fair valued, is asymmetrical to the movement in the guarantee liabilities, which are not fair valued in all cases. The rise in equity markets in 2014 generated negative value movements on the equity derivatives that are held to mitigate against the downside risk of a decline in equity markets.

Due to the IFRS accounting practice, the corresponding offset in the valuation of obligations to customers is not fully recognised leading to a negative movement overall within IFRS profits. Declining interest rates and adverse movements in implied volatility also led to net negative value movements, due to similar accounting asymmetries.

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Jackson designs its hedge programme to protect the economics of the business from large movements in investment markets and therefore accepts a degree of accounting volatility. Viewed through the regulatory surplus lens, the hedge programme was essentially breakeven on this basis, as movements in hedge assets and guarantee reserves broadly offset. Jackson s regulatory risk-based capital ratio was broadly unchanged at 456 per cent at the end of 2014 (31 December 2013: 456 per cent).

The positive short-term fluctuations of £464 million in the UK in 2014 included net unrealised gains on fixed income assets supporting the capital of the shareholder-backed annuity business.

#### IFRS effective tax rates

In 2016, the effective tax rate on operating profit based on longer-term investment returns was 21 per cent, (2015: 20 per cent), reflecting a larger contribution to operating profit from Jackson which attracts a higher rate of tax.

The 2016 effective tax rate on the total IFRS profit was 16 per cent (2015: 18 per cent), reflecting a smaller contribution to the total profit from Jackson which attracts higher rate of tax.

The main driver of the Group's effective tax rate is the relative mix of the profits between countries with higher tax rates (such as the US, Indonesia, and Malaysia), and countries with lower tax rates (such as Hong Kong, Singapore and the UK). The UK has enacted legislation to reduce the corporation tax rate in stages from 20 per cent to 17 per cent from 1 April 2020. The effect of reductions to 17 per cent is reflected in the full year 2016 results. Following the US elections, there is the prospect of significant tax reform occurring in the US, which potentially could reduce the US corporate income tax rate from the current 35 per cent. A number of Asian countries, most notably Indonesia, have indicated they are considering reducing corporation tax rates, but no legislative proposals have been announced to date.

We do not expect that changes being introduced in the UK and other countries to implement recommendations made by the OECD s base erosion and profit shifting project to reform the international tax regime to have any significant impact on the Group.

## **Total tax contribution**

The Group continues to make significant tax contributions in the countries in which it operates, with £2,890 million remitted to tax authorities in 2016. This was lower than the equivalent amount of £3,004 million in 2015, reflecting lower corporation tax payments, partly offset by increases in other taxes borne and taxes collected. In the US a change of basis for taxing derivatives which affects the timing, but not the quantum, of tax payable accelerated tax payments from 2016 into 2015.

#### **Publication of tax strategy**

In 2017, a new UK requirement for large UK businesses to publish their tax strategy will take effect. Prudential s tax strategy, together with further details of the tax payments made in 2016, will be available on the Group s website before 30 June 2017.

## Group and holding company cash flows

Prudential s consolidated cash flow includes the movement in cash included within both policyholders and shareholders funds, such as cash in the with-profits fund. Prudential therefore believes that it is more relevant to

consider individual components of the movement in holding company cash flow which relate solely to the shareholders.

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient remittances are made to service central requirements (including paying the external dividend) and maximising value to shareholders through retention and reinvestment of capital in business opportunities.

Cash remitted to the corporate centre in 2016 amounted to £1,718 million, driven by higher remittances from Asia (up 21 per cent, after adjusting for £42 million of proceeds in 2015 from the sale of our Japan life business). Jackson made sizeable remittances of £420 million, albeit lower than last year when more supportive markets enhanced capital formation. The remittance from UK Life of £300 million was in line with 2015, while the

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remittance from M&G of £290 million was lower than last year reflecting lower levels of post-tax earnings in the year. Actions completed in the period, including internal restructuring that has enabled us to access central resources previously held at intermediary holding and other companies, contributed a further £147 million.

Cash remitted to the Group in 2016 was used to meet central costs of £416 million (2015: £354 million), pay the 2015 second interim ordinary, 2015 special and 2016 first interim dividends and finance the final up-front payment for the renewal of the distribution agreement with Standard Chartered Bank. These movements combined with the net proceeds of debt raised in the year and other corporate cash flows led to holding company cash increasing from £2,173 million to £2,626 million over 2016.

# Capital position, financing and liquidity

## Capital position

With effect from 1 January 2016, the Group is required to adopt Solvency II as its consolidated capital regime. This was developed by the EU in order to harmonise the various regimes previously applied across EU member states. As the regime was primarily designed with European life products in mind, it is a poor fit with Prudential s business given the predominantly non-EU footprint of the Group. The one year value at risk nature of the Solvency II test, which has its roots in banking regulation where risk positions can be priced and readily traded, runs counter to the multi-year nature of life insurance business, where the illiquid nature of liabilities renders such potential market solutions theoretical and not grounded in established sector practices. It also means that solvency capital will be highly volatile.

While Solvency II does not fully recognise the economic capital strength of the Group, we implemented it in 2016 having received internal model approval from the Prudential Regulation Authority in December 2015.

## Analysis of movement in Group shareholder Solvency II surplus\*

	2016 £bn	2015 £bn
Estimated Solvency II surplus at 1 January/economic capital surplus at		
1 January	9.7	9.7
Operating experience	2.7	2.4
Non-operating experience (including market movements)	(1.1)	(0.6)
Other capital movements		
Subordinated debt issuance	1.2	0.6
Foreign currency translation impacts	1.6	0.2
Dividends paid	(1.3)	(1.0)
Methodology and calibration changes	(0.3)	(1.6)
Estimated Solvency II surplus at 31 December	12.5	9.7

<sup>(</sup>i) The methodology and assumptions used in calculating the Solvency II capital results are set out in note II (b) of Additional unaudited financial information.

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk enabled us to enter the new Solvency II regime on 1 January 2016 with a strong Group shareholders capital surplus of £9.7 billion. These factors also provided meaningful protection against the significant adverse market-driven effects on this metric in the first half of 2016. Reflecting the improvement in long-term yields during

the last three months of the year, combined with strong operating capital generation and the beneficial effects of debt issued, the Group shareholders Solvency II capital surplus was estimated at £12.5 billion at 31 December 2016, equivalent to a cover ratio of 201 per cent (1 January 2016: 193 per cent).

Refer to note II(b) of the Additional unaudited financial information section for further information on the Group s Solvency II capital position.

In July 2013, Prudential plc was listed by the Financial Stability Board as one of nine companies to be designated as a Global Systemically Important Insurer, a classification that was reaffirmed in November 2016. Prudential is monitoring the development and potential impact of the related framework of policy measures and is engaging closely with the Prudential Regulation Authority on the implications of this designation.

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## Local statutory capital

All of our subsidiaries continue to hold appropriate capital levels on a local regulatory basis. In the UK, at 31 December 2016 the Prudential Assurance Company Limited and its subsidiaries had an estimated Solvency II shareholder surplus<sup>6</sup> of £4.6 billion (equivalent to a cover ratio of 163 per cent) and a with-profits surplus<sup>7</sup> of £3.7 billion (equivalent to a cover ratio of 179 per cent). In the US, the combination of a high start of year capital level coupled with strong operational capital formation in the year and specific actions taken to strengthen further Jackson s local statutory capital position led to an increase in its Risk Based Capital ratio to 485 per cent (2015: 481 per cent).

## Debt portfolio

The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders exposure to credit is concentrated in the UK annuity portfolio and the US general account, mainly attributable to Jackson s fixed annuity portfolio. The credit exposure is well diversified, with investment grade securities representing 96 per cent of our UK portfolio and 98 per cent of our US portfolio at the end of 2016. During 2016, default losses were minimal and reported impairments of £35 million across these two portfolios were in line with those in 2015.

## Financing and liquidity

#### Shareholders net core structural borrowings

	31 December	
	2016 £m	2015 £m
Total borrowings of shareholder-financed operations	6,798	5,011
Less: Holding company cash and short-term investments	(2,626)	(2,173)
Net core structural borrowings of shareholder-financed operations	4,172	2,838
Gearing ratio*	22%	18%

<sup>\*</sup>Net core structural borrowings as proportion of IFRS shareholders funds plus net debt.

Our financing and central liquidity position remained strong throughout the year. Our central cash resources amounted to £2.6 billion at 31 December 2016 (31 December 2015: £2.2 billion). Total core structural borrowings increased by £1.8 billion to £6.8 billion following the issue of US\$1 billion (£800 million at 31 December 2016) 5.25 per cent tier 2 perpetual subordinated debt in June 2016, US\$725 million (£580 million at 31 December 2016) 4.38 per cent tier 2 perpetual subordinated debt in September 2016 and the impact of currency movements.

In addition to its net core structural borrowings of shareholder-financed operations set out above, the Group also has access to funding via the money markets and has in place an unlimited global commercial paper programme. As at 31 December 2016, we had issued commercial paper under this programme totalling £70 million and US\$1,213 million, to finance non-core borrowings.

Prudential sholding company currently has access to £2.6 billion of syndicated and bilateral committed revolving credit facilities provided by 19 major international banks, expiring in 2021 and 2022. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2016. The medium-term note programme, the SEC registered shelf programme, the commercial paper programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential sholding company and are intended to maintain a strong and flexible funding capacity.

#### Movement on Shareholders Funds

The following table sets forth a summary of the movement in Prudential s IFRS shareholders funds for 2016 and 2015:

Shareholders Funds	2016 £m	2015 £m
Profit after tax for the year	1,921	2,579
Exchange movements, net of related tax	1,161	118
Unrealised gains and losses on Jackson fixed income securities classified as available for		
sale, net of related changes to deferred acquisition costs and tax	31	(629)
Dividends	<b>(1,267)</b>	(974)
Other	(135)	50
Net increase in shareholders funds	1,711	1,144
Shareholders funds at 1 January	12,956	11,812
Shareholders funds at 31 December	14,667	12,956
Shareholders value per share	568p	504p
Return on shareholders funds	26%	27%

<sup>\*</sup>Operating profit after tax and non-controlling interests as percentage of opening shareholders funds. In 2016, UK sterling weakened relative to the US dollar and various Asian currencies. With approximately 49 per cent of the Group s IFRS net assets denominated in non-sterling currencies this generated a positive foreign exchange movement on net assets in the period.

This movement, together with profit after tax, movement in other comprehensive income and dividends paid, has led to the Group s IFRS shareholders funds at 31 December 2016 increasing by 13 per cent to £14.7 billion (31 December 2015: £13.0 billion on an actual exchange rate basis).

## **Corporate transactions**

## 2016

#### Sale of Korea life insurance business

In November 2016 we announced the sale of our Korea life insurance business, PCA Life Insurance Co Ltd. to Mirae Asset Life Insurance Co. Ltd., for KRW170 billion (equivalent to £114 million at 31 December 2016 closing exchange rate) cash consideration. The completion of this sale is subject to regulatory approval. Consistent with the classification of the business as held for sale, the IFRS carrying value has been set to £105 million, representing the estimated proceeds, net of related expenses of £9 million. The IFRS loss of £227 million comprises the 2016 reduction on writing down the carrying value of the business to the agreed sale proceeds (net of costs) together with its profits for the year. The comparative profits for the year have been similarly reclassified as non-operating for consistency of presentation.

## Entrance into Zambia

In June 2016 we completed the acquisition of Professional Life Assurance of Zambia, increasing Prudential s insurance business footprint in Africa to four markets. Across Ghana, Kenya, Uganda and now Zambia we are gradually laying the foundations for what we hope will become a meaningful component of the Group in the years to come. Our current focus in these businesses is on growing our distribution; at 31 December we had 1,750 agents and

were active in 181 branches of our four local bank partners (three exclusive) across these businesses.

## 2015

In June 2015, we completed the acquisition of Ugandan company Goldstar Life Assurance and signed a long-term co-operation agreement with Crane Bank of Uganda. In January 2016 we announced entry into Zambia via our acquisition of Professional Life Assurance, which is expected to complete shortly.

# 2014

# Bancassurance partnership with Standard Chartered PLC

On 12 March 2014 the Group announced that it had entered into an agreement expanding the term and geographic scope of its strategic pan-Asian bancassurance partnership with Standard Chartered PLC. Under the new 15-year agreement, which commenced on 1 July 2014, a wide range of Prudential life insurance products are

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exclusively distributed through Standard Chartered branches in nine markets Hong Kong, Singapore, Indonesia, Thailand, Malaysia, the Philippines, Vietnam, India and Taiwan subject to applicable regulations in each country. In China and South Korea, Standard Chartered Bank will distribute Prudential s life insurance products on a preferred basis. Prudential and Standard Chartered Bank have also agreed to explore additional opportunities to collaborate in due course elsewhere in Asia and in Africa, subject to existing exclusivity arrangements and regulatory restrictions.

As part of this transaction Prudential agreed to pay Standard Chartered Bank an initial fee of US\$1.25 billion which is not dependent on future sales volumes. Of this total, US\$850 million was settled in the first half of 2014. The remainder will be paid in two equal instalments of US\$200 million each in April 2015 and April 2016.

## Sale of PruHealth and PruProtect

On 10 November 2014, Prudential Assurance Company Limited completed the sale of its 25 per cent equity stake in the PruHealth and PruProtect businesses to Discovery Group Europe Limited for £155 million in cash. This resulted in an IFRS profit of £86 million, which has been included in non-operating items.

## Domestication of Hong Kong Branch

On 1 January 2014, the Group completed the process of domestication of the Hong Kong branch of The Prudential Assurance Company Limited. The branch was transferred on 1 January 2014 to two new Hong Kong incorporated Prudential companies, one providing life insurance and the other providing general insurance Prudential Hong Kong Limited and Prudential General Insurance Hong Kong Limited. On the Prudential Regulation Authority s pillar 1 peak 2 basis £12.1 billion of assets, £12.0 billion of liabilities, net of reinsurers share (including policyholder asset share liabilities and £1.2 billion of inherited estate) and £0.1 billion of shareholders funds (for the excess assets of the transferred non-participating business) were transferred.

#### Disposal of Japan life business

In February 2015 the Group completed the disposal of its closed book life insurance business in Japan, PCA Life Insurance Company Limited (PCA Life Japan) to SBI Holding for US\$85 million cash consideration, of which US\$17 million is deferred and is dependent upon the future performance of PCA Life Japan.

## Entrance into Ghana and Kenya Life insurance markets

In April 2014 we completed the acquisition of Express Life of Ghana, and in September 2014 we entered the Kenyan life insurance market via our acquisition of Shield Assurance Company Limited.

## Dividend

During 2016 the Group s dividend policy was updated. The Board will maintain its focus on delivering a growing ordinary dividend. In line with this policy, Prudential aims to grow the ordinary dividend by 5 per cent per annum. The potential for additional distributions will continue to be determined after taking into account the Group s financial flexibility across a broad range of financial metrics and our assessment of opportunities to generate attractive returns by investing in specific areas of the business.

The Board has decided to increase the full-year ordinary dividend by 12 per cent to 43.5 pence per share, reflecting our strong 2016 financial performance and our confidence in the future prospects of the Group. In line with this, the Directors have approved a second interim ordinary dividend of 30.57 pence per share (2015: 26.47 pence per share).

In 2015, a special dividend of 10 pence per share was also awarded.

- <sup>1</sup> Following its reclassification to held for sale during 2016, operating results exclude the contribution of the Korea Life business. The 2015 and 2014 comparative results have been similarly adjusted.
- <sup>2</sup>The Group Solvency II surplus represents the shareholder capital position excluding 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 position also includes the impact of recalculated transitionals at the valuation date, which has reduced the Group shareholder surplus from £12.9 billion to £12.5 billion. The formal Quantitative Reporting Templates (Solvency II templates) will include transitional measures without this recalculation.
- <sup>3</sup> Before allowing for second interim ordinary dividend.
- <sup>4</sup> Following the disposal of the Group s 25 per cent interest in PruHealth and PruProtect in November 2014, the 2014 comparative results of UK insurance operations have been adjusted to exclude results of those businesses.
- <sup>5</sup> Refer to note B1.1 in IFRS financial statements for the breakdown of other income and expenditure and other non-operating items.
- <sup>6</sup> The UK Solvency II surplus represents the shareholder capital position excluding 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 position includes the impact of recalculated transitionals at the valuation date.
- <sup>7</sup> The with-profits Solvency II surplus represents the contribution to Own Funds and the Solvency Capital Requirement from ring fenced funds. The estimated solvency position includes the impact of recalculated transitionals at the valuation date.

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# Explanation of Movements in Profits before Shareholder Tax by Nature of Revenue and Charges

The following table shows Prudential s consolidated total revenue and consolidated total charges for the years presented:

	<b>Actual Exchange Rate</b>		
	2016 £m	2015 £m	2014 £m
Gross premiums earned <sup>(a)</sup>	38,981	36,663	32,832
Outward reinsurance premiums	(2,020)	(1,157)	(799)
Earned premiums, net of reinsurance	36,961	35,506	32,033
Investment return <sup>(b)</sup>	32,511	3,304	25,787
Other income	2,370	2,495	2,306
Total revenue, net of reinsurance	71,842	41,305	60,126
Benefits and claims	(60,948)	(30,547)	(50,736)
Outward reinsurers share of benefit and claims	2,412	1,389	631
Movement in unallocated surplus of with-profits funds	(830)	(498)	(64)
Benefits and claims and movement in unallocated surplus of with-profits funds,			
net of reinsurance <sup>(c)</sup>	(59,366)	(29,656)	(50,169)
Acquisition costs and other expenditure <sup>(d)</sup>	(8,848)	(8,208)	(6,752)
Finance costs: interest on core structural borrowings of shareholder-financed			
operations	(360)	(312)	(341)
Remeasurement of carrying value of Korea life business classified as held for sale	(238)	-	-
Disposal of Japan life business cumulative exchange loss recycled from other			
comprehensive income	-	(46)	-
Disposal of Japan life business remeasurement adjustments	-	-	(13)
Total charges, net of reinsurance	(68,812)	(38,222)	(57,275)
Share of profits from joint ventures and associates, net of related tax	182	238	303
Profit before tax (being tax attributable to shareholders and policyholders			
returns)*	3,212	3,321	3,154
Less tax charge attributable to policyholders returns	(937)	(173)	(540)
Profit before tax attributable to shareholders	2,275	3,148	2,614
Total tax charge attributable to policyholders and shareholders	(1,291)	(742)	(938)
Adjustment to remove tax charge attributable to policyholders returns	937	173	540
Tax charge attributable to shareholders returns	(354)	(569)	(398)
Profit for the year attributable to equity holders of the Company	1,921	2,579	2,216

<sup>\*</sup> 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 the PAC with-profits fund after adjusting for taxes borne by policyholders.

# (a) Gross earned premiums

	Year	Year ended 31 December £m		
	2016	2015	2014	
Asian operations*	14,006	10,814	9,820	
US operations	14,685	16,887	15,654	
UK operations*	10,290	8,962	7,358	
Total	38.981	36,663	32,832	

<sup>\*</sup> The Asia and UK premiums exclude intra-group transactions.

Gross earned premiums for insurance operations totalled £38,981 million in 2016, up 6 per cent from £36,663 million in 2015. The increase of £2,318 million was driven by growth of £1,328 million in the UK operations and £3,192 million in the Asia operations, which was partially offset by a decline of £2,202 million in the US operations.

Gross earned premiums for insurance operations totalled £36,663 million in 2015, up 12 per cent from £32,832 million in 2014. The increase of £3,831 million was driven by growth of £1,604 million in the UK operations; £1,233 million in the US operations; and £994 million in the Asia operations.

#### Asia

Gross earned premiums increased by 30 per cent from £10,814 million in 2015 to £14,006 million in 2016 and by 10 per cent from £9,820 million in 2014 to £10,814 million in 2015 on an actual exchange rate basis.

Excluding the impact of exchange translation, gross earned premiums in Asia increased by 16 per cent from 2015 to 2016, from £12,067 million on a constant exchange rate in 2015 to £14,006 million in 2016. The premiums reflect the aggregate of single and recurrent premiums of new business sold in the year and premiums on annual business sold in previous years. The growth in earned premiums reflects increases for both factors.

Sales progression in Asia has been strongest in the agency channel, as we continue to drive improvements in productivity and invest in recruitment initiatives to underpin future sales prospects. The fourth quarter saw an acceleration in the positive trends observed earlier in the year, with 8 of our markets in the region seeing considerable growth. Despite the strength of this growth our focus on quality is undiminished, with regular premiums on long-term contracts accounting for the majority of the sales and a continuing high proportion of new business from health and protection coverage. This favourable mix provides a high level of recurring income and an earnings profile that is significantly less correlated to investment markets.

Our businesses in China and Hong Kong have performed well in 2016 demonstrating the extent of the opportunity in these markets. In Hong Kong, we continue to generate business from both Mainland China residents and local customers, with a strong bias for regular premiums and an increasing contribution from health and protection business. 2016 saw increased intervention by the Chinese authorities in relation to capital controls and we continue to monitor developments, which to date have not had a meaningful impact on our business in Hong Kong. In China, we have pivoted the business towards higher quality regular premium business driven by our increased scale in the agency channel, and sales of single premiums have reduced as we de-emphasised further new spread-based business across the region in 2016.

In Indonesia, trading conditions remain challenging, and in such an environment we have retained our more cautious approach to new business. In Malaysia, sales increased driven by improvements in the conventional agency channel and increased contributions from our bancassurance partners. In Singapore, sales increased in the second half relative to the equivalent period last year, driven by increased agent activation and a recovery in bancassurance sales.

Gross earned premiums increased by 10 per cent from £9,820 million in 2014 to £10,814 million in on an actual exchange rate basis.

Excluding the impact of exchange translation, gross earned premiums in Asia increased by 8 per cent from 2014 to 2015, from £10,004 million on a constant exchange rate in 2014 to £10,814 million in 2015. Our sales performance in Asia continued to benefit from our broad-based multi-channel distribution platform, new product launches and continued actions to improve both distribution scale and productivity. Single premium sales, which are more susceptible to softer economic conditions saw a modest reduction in 2015.

## **United States**

Gross premiums decreased by 13 per cent from £16,887 million in 2015 to £14,685 million in 2016 on an actual exchange rate basis. Excluding the impact of exchange translation, gross premiums in the US decreased by 23 per cent from £19,053 million on a constant exchange rate in 2015 to £14,685 million in 2016. In the US, uncertainty following the announcement of the Department of Labor s fiduciary duty rule on the distribution of retirement market products has contributed to a marked decline of 22 per cent¹ in industry sales of variable annuities. Jackson s sales from all variable annuity products were also lower as a result. Notwithstanding this reduction in sales, net inflows into Jackson s separate account asset balances, which drive fee-based earnings on variable annuity business, remained positive at £4.4 billion. More favourable market conditions in the institutional product market provided Jackson with the opportunity to write more business 2016 compared with 2015.

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Gross premiums increased by 8 per cent from £15,654 million in 2014 to £16,887 million in 2015 on an actual exchange rate basis. Excluding the impact of exchange translation, gross premiums in the US remained broadly flat from 2014 to 2015 from £16,876 million on a constant exchange rate in 2014 (based on the exchange rates in 2015) to £16,887 million in 2015. Total variable annuity sales remained flat compared with 2014, reflecting Jackson s continued focus on proactively managing sales of products with living benefits to maintain an appropriate balance of revenue streams and match its annual risk appetite. The proportion of variable annuity sales without living benefits remains significant and broadly in line with last year with Elite Access continuing to be the leader in the investment-only variable annuity market.

# <sup>1</sup> LIMRA/Secure Retirement Institute, US Industrial Annuity participants Report Q3 YTD 2016. *United Kingdom*

Gross premiums for UK operations increased by 15 per cent from £8,962 million in 2015 to £10,290 million in 2016, mainly due to our strategy of extending customer access to PruFund s with-profits investment option via additional product wrappers continues to drive growth in sales. In the current low interest rate environment, consumers are attracted to PruFund s smoothed multi-asset fund returns and the financial security attaching to its strong capitalisation. We have seen notable success with the build out of PruFund through individual pensions, income drawdown and ISAs. Reflecting this strong performance, total PruFund assets under management of £24.7 billion as at 31 December 2016 were 50 per cent higher than at the start of the year.

Despite this increase, sales from new annuity business reduced from £123 million in 2015 to £41 million, as we scale down our participation in the annuity market.

Gross premiums for UK operations increased from £7,358 million in 2014 to £8,962 million in 2015, mainly due to growing demand for our savings and retirement products and specifically the distinctive PruFund range, with momentum increasing through the year as additional products and services came online including PruFund ISA, flexible income drawdown and our simplified non-advised drawdown pension choices plan.

## (b) Investment return

	Year	Year ended 31 December £m		
	2016	2015	2014	
Asia operations	2,917	(296)	3,891	
US operations	7,612	(789)	5,436	
UK operations	22,101	4,417	16,551	
Unallocated corporate and intra-group elimination	(119)	(28)	(91)	
Total	32,511	3,304	25,787	

Investment return principally comprises interest income, dividends, investment appreciation/depreciation (realised and unrealised gains and losses) on investments designated as fair value through profit and loss and realised gains and losses, including impairment losses, on securities designated as amortised cost and available-for-sale. Movements in unrealised appreciation/depreciation of Jackson s debt securities designated as amortised cost and available-for-sale are not reflected in investment return but are recorded in other comprehensive income.

Allocation of investment return between policyholders and shareholders

Investment return is attributable to policyholders and shareholders. A key feature of the accounting policies under IFRS is that the investment return included in the income statement relates to all investment assets of the Group, irrespective of whether the return is attributable to shareholders, or to policyholders or the unallocated surplus of with-profits funds, the latter two of which have no direct impact on shareholders profit. The table below provides a breakdown of the investment return for each regional operation attributable to each type of business.

	2016 £m	2015 £m	2014 £m
Asia operations			
Policyholder returns			
Assets backing unit-linked liabilities	822	(626)	1,069
With-profits business	1,454	(75)	1,915
	2,276	(701)	2,984
Shareholder returns	641	405	907
Total	2,917	(296)	3,891
US operations			
Policyholder returns - Assets held to back separate account			
(unit-linked) liabilities	7,917	(2,033)	3,793
Shareholder returns	(305)	1,244	1,643
Total	7,612	(789)	5,436
UK operations			
Policyholder returns			
Scottish Amicable Insurance Fund (SAIF)	874	212	608
Assets held to back unit-linked liabilities	3,134	699	1,848
With-profits fund (excluding SAIF)	13,224	3,131	8,958
	17,232	4,042	11,414
Shareholder returns	4,869	375	5,137
Total	22,101	4,417	16,551
Unallocated corporate			
Shareholder returns	(119)	(28)	(91)
Group Total			
Policyholder returns	27,425	1,308	18,191
Shareholder returns	5,086	1,996	7,596
Total	32,511	3,304	25,787

Policyholder returns

The returns as shown in the table above are delineated between those returns allocated to policyholders and those allocated to shareholders. In making this distinction, returns allocated to policyholders are those from investments in which shareholders have no direct economic interest, namely:

Unit-linked business in the UK and Asia, and Scottish Amicable Insurance Fund (SAIF) in the UK, for which the investment returns are wholly attributable to policyholders;

Separate account business of US operations, the investment returns of which are also wholly attributable to policyholders; and

With-profits business (excluding SAIF) in the UK and Asia (in which the shareholders—economic interest, and the basis of recognising IFRS basis profits, is restricted to a share of the actuarially determined surplus for distribution (in the UK 10 per cent)). Except for this surplus the investment returns of the with-profits funds are attributable to policyholders (through the asset-share liabilities) or the unallocated surplus, which is accounted for as a liability under IFRS 4.

The investment returns related to the types of business mentioned above do not impact shareholders profits directly. However, there is an indirect impact, for example, investment-related fees or the effect of investment returns on the shareholders share of the cost of bonuses of with-profits funds.

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Investment returns for unit-linked and similar products have a reciprocal impact on benefits and claims, with an increase/decrease in market returns on the attached pool of assets affecting policyholder benefits on these products. Similarly for with-profits funds there is a close correlation between increases or decreases in investment returns and the level of combined charge for policyholder benefits and movement on unallocated surplus that arises from such returns.

#### Shareholder returns

For shareholder-backed non-participating business in the UK (comprising its shareholder-backed annuity and other non-linked non-participating business) and of the Asia operations, the investment returns are not directly attributable to policyholders and therefore, impact shareholders—profit directly. However, for UK shareholder-backed annuity business, where the durations of asset and liability cash flows are closely matched, the discount rate applied to measure liabilities to policyholders (under—grandfathered—UK GAAP and under IFRS 4) reflects movements in asset yields (after allowances for the future defaults) of the backing portfolios. Therefore, the net impact on the shareholders profits of the investment returns of the assets backing liabilities of the UK shareholder-backed annuity business is determined after taking into account the consequential effect on the movement in policyholder liabilities.

Changes in shareholders investment returns for US operations reflect primarily movements in the investment income, and realised gains and losses together with movements in the value of the derivative instruments held to manage interest rate exposures and durations within the general account (including variable annuity and fixed index annuity guarantees), GMIB reinsurance and equity derivatives held to manage the equity risk exposure of guarantee liabilities. Separately within Benefits and Claims, there is a charge for the allocation made to policyholders through the application of crediting rates for Jackson s relevant lines of business.

The majority of the investments held to back the US general account business are debt securities for which the available-for-sale designation is applied for IFRS basis reporting. Under this designation the return included in the income statement reflects the aggregate of investment income and realised gains and losses (including impairment losses). However, movements in unrealised appreciation or depreciation are recognised in other comprehensive income. The return on these assets is attributable to shareholders.

Reasons for year-on-year changes in investment returns

With two exceptions, all Prudential investments are carried at fair value in the statement of financial position with fair value movements, which are volatile from year to year, recorded in the income statement. The exceptions are for:

- (i) debt securities in the general account of US operations, the return on which is attributable to shareholders and which are accounted for on an IAS 39 available-for-sale basis. In this respect realised gains and losses (including impairment losses) are recorded in the income statement, while movements in unrealised appreciation (depreciation) are booked as other comprehensive income. As a result, the changes in unrealised fair value of these debt securities are not reflected in Prudential s investment returns in the income statement. The unrealised gains and losses in the income statement of US operations primarily arise on the assets of the US separate account business; and
- (ii) loans and receivables, which are carried at amortised cost.

Subject to the effect of these two exceptions, the year-on-year changes in investment returns primarily reflect the generality of overall market movements for equities, debt securities and, in the UK, for investment property mainly held by with-profits funds. In addition for Asia and US separate account business, foreign exchange rates affect the

sterling value of the translated income. Consistent with the treatment applied for other items of income and expenditure, investment returns for overseas operations are translated at average exchange rates.

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Asia

The table below provides an analysis of investment return attributable to Asia operations for the years presented:

	Year ended 31 December £m		
	2016	2015	2014
Interest/dividend income (including foreign exchange gains and losses)	1,513	1,028	1,030
Investment appreciation/(depreciation)	1,404	(1,324)	2,861
Total	2,917	(296)	3.891

In Prudential s Asia operations, debt securities accounted for 55 per cent, 57 per cent and 52 per cent of the total investment portfolio as at 31 December 2016, 2015 and 2014, respectively, with equities comprising 36 per cent, 38 per cent and 43 per cent, respectively. The remaining 9 per cent, 5 per cent and 5 per cent of the total investment portfolio, respectively, primarily comprised loans and deposits with credit institutions. Investment return increased from a loss of £296 million in 2015 to a gain of £2,917 million in 2016. This increase was due primarily to an increase of £2,728 million in investment appreciation from £1,324 million of depreciation in 2015 to an appreciation of £1,404 million in 2016. The changes in the equity markets and the interest rates affecting the value movement in debt securities during 2016 have been mixed across the region. The gain of £2,728 million was driven primarily by favourable change in the debt securities and equities held by the with-profits funds and unit-linked business of the Asia operations.

Investment return decreased from £3,891 million in 2014 to £(296) million in 2015. This decrease was due primarily to a decrease of £4,185 million in investment appreciation from £2,861 million of appreciation in 2014 to a depreciation of £1,324 million in 2015. The charge of £4,185 million was driven primarily by adverse movements on debt securities values following movements in bond yields across the region during the year and less favourable equity market movements compared with 2014.

#### **United States**

The table below provides an analysis of investment return attributable to US operations for the years presented:

	Year ended 31 December £m		
	2016	2015	2014
Investment return of investments backing US separate account liabilities	7,917	(2,033)	3,793
Other investment return	(305)	1,244	1,643
Total	7,612	(789)	5,436

In the US, investment return increased from negative £789 million in 2015 to £7,612 million in 2016. This £8,401 million favourable change arose from an increase of £9,950 million in the investment return on investments backing variable separate account liabilities from a loss of £2,033 million in 2015 to a gain of £7,917 million in 2016 and a decrease of £1,549 million in other investment return from a gain of £1,244 million to a loss of £305 million. The primary driver for the £8,401 million increase in investment return on investments backing variable annuity separate account liabilities as compared with 2015 was the favourable movements in the US equity markets in 2016 on a larger separate account asset balance. The decrease in other investment return reflects the value movements in derivatives held to manage interest rate and equity risk exposures as discussed in note B1.2 to the consolidated financial statements.

Investment return decreased from £5,436 million in 2014 to negative £789 million in 2015. This £6,225 million adverse change arose from a decrease of £5,826 million in the investment return on investments backing variable separate account liabilities from a gain of £3,793 million in 2014 to a loss of £2,033 million in 2015 and a decrease of £399 million in other investment return from £1,643 million to £1,244 million. The primary driver for the £5,826 million decrease in investment return on investments backing variable annuity separate account liabilities as compared with 2014 was the adverse movements in the US equity markets in 2015 on a larger separate account asset balance. The decrease in other investment return reflects the value movements in derivatives held to manage interest rate and equity risk exposures as discussed in note B1.2 to the consolidated financial statements.

## United Kingdom

The table below provides an analysis of investment return attributable to UK operations for the years presented:

	Year ended 31 December £m		
	2016	2015	2014
Interest/dividend income	6,019	6,430	6,056
Investment appreciation (depreciation) and other investment return	16,082	(2,013)	10,495
Total	22,101	4,417	16,551

In Prudential s UK operations, equities accounted for 29 per cent, 28 per cent and 26 per cent of the total investment portfolio as at 31 December 2016, 2015 and 2014, respectively. Debt securities comprised 50 per cent, 51 per cent and 53 per cent, respectively, with investment properties accounting for 8 per cent, 8 per cent and 8 per cent of the total investment portfolio in each respective year. The remaining 13 per cent, 13 per cent and 13 per cent of the total investment portfolio as at 31 December 2016, 2015 and 2014, respectively, related to loans, deposits with credit institutions, investments in partnerships in investment pools and derivative assets. Within debt securities of £93 billion (2015: £85 billion; 2014: £89 billion) as at 31 December 2016, 66 per cent (2015: 68 per cent; 2014: 70 per cent) consisted of corporate debt securities.

Interest and dividend income decreased by £411 million from £6,430 million in 2015 to £6,019 million in 2016, and increased by £374 million from £6,056 million in 2014 to £6,430 million in 2015.

The increase in investment appreciation and other investment return of £18,095 million from a loss of £2,013 million in 2015 to a gain of £16,082 million in 2016 principally reflects gains on bonds following fall in UK gilt yields in 2016.

Unallocated corporate and intragroup elimination

Investment return for unallocated corporate and intragroup elimination was negative £119 million in 2016 compared with negative £28 million in 2015 and negative £91 million in 2014.

#### (c) Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance

	Year	Year ended 31 December £m		
	2016	2015	2014	
Asia operations*	(11,311)	(6,555)	(9,794)	
US operations	(20,214)	(13,029)	(19,761)	
UK operations*	(27,841)	(10,072)	(20,614)	
Total	(59,366)	(29,656)	(50,169)	

<sup>\*</sup> The Asia and UK benefits and claims exclude intra-group transactions.

Benefits and claims represent payments, including final bonuses, to policyholders in respect of maturities, surrenders and deaths plus changes in technical provisions (which primarily represent the movement in amounts owed to policyholders). Benefits and claims are amounts attributable to policyholders. The movement in unallocated surplus of with-profits funds represents the transfer to (from) the unallocated surplus each year through a charge (credit) to the

income statement of the annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders.

The underlying reasons for the year-on-year changes in benefits and claims and movement in unallocated surplus in each of Prudential s regional operations are changes in the incidence of claims incurred, increases or decreases in policyholders liabilities, and movements in unallocated surplus of with-profits funds.

Total benefit and claims and movements in unallocated surplus of with-profits funds increased by £29,710 million in 2016 to a charge of £59,366 million compared with a charge of £29,656 million in 2015 and a charge of £50,169 million in 2014. The amounts of this year-on-year charge attributable to each of the underlying reasons as stated above are shown below.

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Benefits and claims and movements in unallocated surplus of with-profits funds net of reinsurance can be further analysed as follows.

	Year ended 31 December £m		
	2016	2015	2014
Claims incurred, net of reinsurance	(25,730)	(23,763)	(22,331)
Increase in policyholder liabilities, net of reinsurance	(32,804)	(5,395)	(27,774)
Movement in unallocated surplus of with-profits funds	(832)	(498)	(64)
Benefits and claims and movement in unallocated surplus, net of			
reinsurance	(59,366)	(29,656)	(50,169)

The charge for benefits and claims and movements in unallocated surplus, net of reinsurance of £59,366 million (2015: £29,656 million; 2014: £50,169 million) shown in the table above includes the effect of accounting for investment contracts without discretionary participation features (as defined by IFRS 4) in accordance with IAS 39 to reflect the deposit nature of the arrangement.

Additionally the movement in policyholder liabilities and unallocated surplus of with-profits funds represents the amount recognised in the income statement and therefore excludes the effect of foreign exchange translation differences on the policyholder liabilities of foreign subsidiaries and the movement in liabilities arising on acquisition and disposals of subsidiaries in the year.

The movement in policyholder liabilities recognised in the income statement includes reserving for inflows from premiums net of upfront charges, release of liabilities for claims paid on surrenders, withdrawals, maturities and deaths, change due to investment return to the extent of the amounts allocated to policyholders or reflected in the measurement of the policyholder liabilities and other changes in the liability measurement.

However, the principal driver for the year on year variations in the increases and decreases in policyholder liabilities is the investment return element due to the inherent nature of market fluctuations. These variations are driven by changes to investment return reflected in the statement of financial position measurement of liabilities for Prudential s with-profits, SAIF and unit-linked policies (including US separate account business). In addition, for those liabilities under IFRS, in particular, liabilities relating to the UK annuity business, where the measurement reflects the yields on assets backing the liabilities, the year-on-year changes in investment yields also contribute significantly to variations in the measurement of policyholder liabilities. The principal driver for variations in the change in unallocated surplus of with-profits funds is the value movements on the investment assets of the with-profits funds to the extent not reflected in policyholder liabilities.

An analysis of statement of financial position movements in policyholder liabilities and unallocated surplus of with-profits funds is provided in note C4.1 to the consolidated financial statements. The policyholder liabilities shown in the analysis in note C4.1 are gross of reinsurance and include the full movement in the year of investment contracts without discretionary participating features (as defined in IFRS 4). Further, this analysis has been prepared to include the Group s share of the policyholder liabilities of the Asia joint ventures that are accounted for on an equity method basis in the Group s financial statements.

The principal variations in the movements in policyholder liabilities and movements in unallocated surplus of with-profits funds for each regional operation are discussed below.

Asia

In 2016, benefits and claims and movements in unallocated surplus of with-profits funds totalled £11,311 million, representing an increase of £4,756 million compared with the charge of £6,555 million in 2015. In 2015, benefits and claims and movements in unallocated surplus of with-profits funds totalled £6,555 million, representing a decrease of £3,239 million compared with the charge of £9,794 million in 2014.

The amounts of the year-on-year change attributable to each of the underlying reasons are shown below:

	Year ended 31 December £m		
	2016	2015	2014
Claims incurred, net of reinsurance	(4,530)	(4,151)	(4,351)
Increase in policyholder liabilities, net of reinsurance	(7,120)	(2,074)	(5,463)
Movement in unallocated surplus of with-profits funds	339	(330)	20
Benefits and claims and movement in unallocated surplus, net of			
reinsurance	(11,311)	(6,555)	(9,794)

The growth in the policyholder liabilities in Asia over the three-year period reflected the increase due to the combined growth of new business and the in-force books in the region.

The variations in the movements in policyholder liabilities in individual years were, however, primarily due to movement in investment returns. This was as a result of asset value movements that are reflected in the unit value of the unit-linked policies, which represent a significant proportion of the Asia operations business. In addition, the policyholder liabilities of the Asia operations with-profits policies also fluctuated with the investment performance of the funds.

#### **United States**

Except for institutional products and certain term annuities which are classified as investment products under IAS 39 for the purpose of IFRS reporting, deposits into the US operations products are recorded as premiums, withdrawals and surrenders and are included in benefits and claims, and the resulting net movement is recorded under other reserve movements within benefits and claims. Benefits and claims also include interest credited to policyholders.

In 2016, the accounting charge for benefits and claims increased by £7,185 million to £20,214 million compared with £13,029 million in 2015. In 2015, the accounting charge for benefits and claims decreased by £6,732 million to £13,029 million compared with £19,761 million in 2014.

The amounts of the year-on-year change attributable to each of the underlying reasons are shown below:

	Year ended 31 December £m		
	2016	2015	2014
Claims incurred, net of reinsurance	(11,026)	(9,688)	(8,506)
Increase in policyholder liabilities, net of reinsurance	(9,188)	(3,341)	(11,255)
Benefits and claims, net of reinsurance	(20,214)	(13,029)	(19,761)

The movements year-on-year in the claims incurred for the US operations as shown in the table above also included the effects of translating the US dollar results into pounds sterling at the average exchange rates for the relevant years.

The charges in each year comprise amounts in respect of variable annuity and other business. For variable annuity business, there are two principal factors that contribute to the variations in the charge, in any given period. First, the investment return on the assets backing the variable annuity separate account liabilities changed to a £7,917 million credit in 2016 from a £2,033 million debit in 2015 and a £3,793 million credit in 2014 as shown in the section Investment return (b) United States above. The second principal effect is the growth of the variable annuity business

in force. This can be illustrated by the positive net cash flows of the US insurance operations—variable annuity separate account liabilities in note C4.1(c)—Reconciliation of movement in policyholder liabilities—to the consolidated financial statements. The net flows of the variable annuity separate account liabilities shown in that note were a positive  $\pounds 4,393$  million in 2016 with a positive  $\pounds 7,887$  million for 2015 and a positive  $\pounds 7,974$  million for 2014.

#### United Kingdom

Overall, benefits and claims and the movement in unallocated surplus recorded in the income statement was a charge of £27,841 million in 2016 compared with a £10,072 million charge in 2015 and a £20,614 million charge in 2014. The year-on-year changes attributable to each of the underlying reasons are shown below, together with a further analysis of the amounts included in respect of the movements in policyholder liabilities by type of business:

	Year ended 31 December £m		
	2016	2015	2014
Claims incurred, net of reinsurance	(10,174)	(9,924)	(9,474)
Decrease/(increase) in policyholder liabilities, net of reinsurance			
SAIF	39	752	366
Shareholder-backed annuity business	(2,591)	301	(2,157)
Unit-linked and other non-participating business	(2,080)	171	(3,536)
With-profits (excluding SAIF)	(11,865)	(1,204)	(5,729)
	(16,498)	20	(11,056)
Movement in unallocated surplus of with-profits funds	<b>(1,169)</b>	(168)	(84)
Benefits and claims and movement in unallocated surplus, net of			
reinsurance	(27,841)	(10,072)	(20,614)

Claims incurred in the UK operations in 2016 were £10,174 million, compared with £9,924 million in 2015 and £9,474 million in 2014.

As has been explained above, the principal driver for variations in amounts allocated to the policyholders is changes to investment returns.

In aggregate, as a result of the higher market returns in 2016 compared with 2015 there has been a corresponding impact on benefits and claims and movements in unallocated surplus of with-profits funds in the year, moving from a net charge of £10,072 million in 2015 to a net charge of £27,841 million in 2016. Conversely, the market returns in 2015 were negative compared with 2014, resulting in a movement from a net charge of £20,614 million in 2014 to a net charge of £10,072 million in 2015.

SAIF is a ring-fenced fund with no new business written. The decrease in policyholder liabilities in SAIF reflects the underlying decreasing policyholder liabilities as the liabilities run off. The variations from year to year are, however, affected by the market valuation movement of the investments held by SAIF, which are wholly attributable to policyholders.

For shareholder-backed annuity business, the decreases/(increases) in policyholder liabilities reflect the effect of altered investment yield reflected in the discount rate applied in the measurement of the liabilities, together with other factors such as changes in premium income for new business and altered assumptions.

For unit-linked business, the primary driver of the variations in the decreases/(increases) in the policyholder liabilities were due to the movement in the market value of the unit-linked assets as reflected in the unit value of the unit-linked policies.

The part of Prudential where variations in amounts attributed to policyholder liabilities and unallocated surplus are most significant is the UK with-profits business (excluding SAIF). As explained in note C4.2 to the consolidated

financial statements, the liabilities for UK with-profits policyholders are determined on an asset-share basis that incorporates the accumulation of investment returns and all other items of income and outgoings that are relevant to each policy type. Accordingly, the movement in policyholder liabilities in the income statement will fluctuate with the investment return of the fund. Separately, the excess of assets over liabilities of the fund represents the unallocated surplus. This surplus will also fluctuate on a similar basis to the market value movement on the investment assets of the fund with the movement reflected in the income statement. In addition, other items of income and expenditure affect the level of movement in policyholder liabilities (to the extent reflected in assets shares) and unallocated surplus.

The correlation between total net income (loss) before benefits and claims and movement in unallocated surplus, on the one hand, and the (charge) credit for benefits and claims and movement in unallocated surplus, on the other, for the UK component of the PAC with-profits fund (excluding SAIF) is illustrated numerically by the following table for each of the years presented. In summary, the correlation principally arises due to the following factors:

- (a) Investment return is included in full in the income statement and is attributable either to contracts or unallocated surplus.
- (b) Investment return, to the extent attributable to contracts, directly affects asset share liabilities, which are reflected in the income statement through changes in policyholder liabilities.
- (c) Investment return, to the extent attributable to unallocated surplus, forms the majority part of the movement in such surplus in the income statement.

	Year ended 31 December £m		
	2016	2015	2014
Earned premiums, net of reinsurance <sup>(i)</sup>	9,261	6,507	3,007
Investment return	13,185	3,130	8,958
Other income	177	210	72
Acquisition costs and other expenditure	(1,288)	(1,318)	(961)
Share of profit from joint ventures	22	53	129
Tax charge	(739)	(148)	(440)
Total net income before benefit and claims and movement in unallocated			
surplus, net of reinsurance	20,618	8,434	10,765
Charges of:			
Claims incurred	(7,410)	(6,745)	(6,115)
Increase in policyholder liabilities <sup>(i)</sup>	(11,824)	(1,307)	(4,366)
Movement in unallocated surplus of with-profits funds	(1,169)	(168)	(84)
Benefits and claims and movements in unallocated surplus of with-profits			
funds, net of reinsurance	(20,403)	(8,220)	(10,565)
Shareholders profit after tax	215	214	200
Note			

(i) For the purposes of presentation in Prudential s consolidated financial information, references to the UK with-profits fund also include, for convenience, the amounts attaching to Prudential s UK Defined Charge Participating Sub-fund which includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 31 December 2007. Profits to shareholders emerge on a charges less expenses basis and policyholders are entitled to 100 per cent of the investment earnings.

Separately, the cost of current year bonuses which are attributable to policyholders is booked within the movement in policyholder liabilities. One-ninth of the declared cost of policyholders bonus is attributable to shareholders and represents the shareholders profit. Both of these amounts, by comparison with the investment return, movement in other constituent elements of the change in policyholder liabilities and the change in unallocated surplus, are relatively stable from year to year.

In 2016, the income statement of the UK component of the PAC with-profits funds was charged with a transfer of £1,169 million to the unallocated surplus. This transfer, together with a corresponding transfer in the unallocated surplus of the Asia with-profits funds and the effect of exchange rate movements, resulted in an increase in

Prudential s unallocated surplus from £13.1 billion in 2015 to £14.3 billion in 2016. This movement reflected the net effect of changes in the value of assets, liabilities (incorporating policyholder bonuses and other elements of asset shares attributable to policyholders), and the shareholders share of the cost of bonuses for 2016.

The surplus for distribution in future years will reflect the aggregate of policyholder bonuses and the cost of bonuses attributable to shareholders, which is currently set at 10 per cent of the total bonus. The policyholder bonuses comprise the aggregate of regular and final bonuses. When determining policy payouts, including final bonuses, Prudential considers asset shares of specimen policies.

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

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In the unlikely circumstance that the depletion of excess assets within the long-term fund was such that Prudential s ability to treat its customers fairly was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders funds to the long-term funds to provide financial support.

The factors that the PAC Board considers in setting bonus rates are described in more detail in the section headed With-profits products in the section headed United Kingdom Basis of profits Bonus Rates and are summarised in note C4.2(c) UK to the consolidated financial statements.

## (d) Acquisition costs and other expenditure

	Year	Year ended 31 December £m		
	2016	2015	2014	
Asia operations	(3,868)	(2,929)	(2,616)	
US operations	(1,963)	(2,376)	(1,589)	
UK operations	(3,083)	(2,917)	(2,580)	
Unallocated corporate and intra-group elimination	66	14	33	
Total	(8,848)	(8,208)	(6,752)	

Total acquisition costs and other expenditure of £8,848 million in 2016 were 8 per cent higher than the £8,208 million incurred in 2015. Total acquisition costs and other expenditure of £8,208 million in 2015 were 22 per cent lower than the £6,752 million incurred in 2014.

#### Asia

Total acquisition costs and other expenditure for Asia in 2016 were £3,868 million compared with £2,929 million in 2015 and £2,616 million in 2014. The increase of £939 million from 2015 to 2016 and £313 million from 2014 to 2015 were due to increased acquisition costs and increases in other operating expenses as the business continues to expand. The increase of £939 million from 2015 to 2016 includes an exchange translation impact of £347 million. Excluding the effect of currency volatility, total acquisition costs and other expenditure increased by £592 million from 2015 to 2016.

## **United States**

Total acquisition costs and other expenditure for the US of £1,963 million in 2016 represented a decrease of £413 million over the amount of £2,376 million in 2015. The £2,376 million in 2015 in turn represented an increase of £787 million from the £1,589 million in 2014.

The decrease of £413 million from 2015 to 2016 includes an exchange translation impact of £304 million. Excluding the effect of currency volatility, total acquisition costs and other expenditure decreased by £717 million from 2015 to 2016.

The year-on-year movements primarily reflected changes in the charge for acquisition costs in the income statement, net of change in deferred acquisition costs, of which a significant element is due to the amortisation attaching to the varying level of short-term fluctuations in investment returns in each year.

# United Kingdom

Total acquisition costs and other expenditure for the UK increased by 6 per cent from £2,917 million in 2015 to £3,083 million in 2016. Total acquisition costs and other expenditure for the UK increased by 13 per cent from £2,580 million in 2014 to £2,917 million in 2015.

The year-on-year movements were primarily affected by the changes in the charge for investment gains relating to funds managed on behalf of third parties which are consolidated but have no recourse to the Group, which decreased by £496 million from £769 million in 2015 to £273 million in 2016 and increased by £361 million from 2014 to 2015. The 2016 other expenditure for the UK includes the establishment of a £175 million provision for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress.

Unallocated corporate and intra-group elimination

Other net expenditure represented a credit of £66 million in 2016, a credit of £14 million in 2015 and a credit of £33 million in 2014.

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# **Exchange Rate Information**

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

Year ended 31 December	Average rate
2012	1.59
2013	1.56
2014	1.65
2015	1.53
2016	1.35

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

	High	Low
September 2016	1.34	1.30
October 2016	1.28	1.22
November 2016	1.25	1.22
December 2016	1.27	1.22
January 2017	1.26	1.21
February 2017	1.26	1.24

On 17 March 2017 the latest practicable date prior to this filing, the noon buying rate was £1.00 = \$1.24

# **EEV Basis, New Business Results and Free Surplus Generation**

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

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

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

Underlying free surplus generation is used to measure the internal cash generation by our business units. For the insurance operations it represents amounts maturing from the in-force business during the period less investment in new business and excludes other non-operating items. For asset management it equates to post-tax IFRS operating profit based on longer-term investment returns for the period.

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# **Additional Information on Liquidity and Capital Resources**

Prudential Capital operates a central treasury function for Prudential, which has overall responsibility for managing Prudential s capital funding program as well as its central cash and liquidity positions. Prudential arranges the financing of each of its subsidiaries primarily by raising external finance either at the parent company level or at the operating company level.

After making sufficient enquiries the directors of Prudential have a reasonable expectation that the Company and the Group have adequate resources to continue their operations for a period of at least 12 months from the date that the financial statements are approved.

## Liquidity sources

The parent company including the central finance subsidiaries held cash and short-term investments of £2,626 million, £2,173 million and £1,480 million as at 31 December 2016, 2015 and 2014, respectively. The sources of cash in 2016 included dividends, loans and net cash amounts received from operating subsidiaries. Prudential received £1,718 million in net cash remittances from business units in 2016, compared with £1,625 million received in 2015 and £1,482 million received in 2014. These remittances primarily comprise dividends from business units and the shareholders statutory transfer from the PAC long-term with-profits fund (UK Life Fund) relating to earlier bonus declarations.

#### Shareholders statutory transfer

In 2016, PAC declared a total surplus of £2,198 million (2015: £2,208 million) from PAC s primary with-profits sub-fund, of which £1,983 million (2015: £1,994 million) was added to with-profits policies and £215 million (2015: £214 million) was distributed to shareholders. These amounts included annual bonus rates of 1.50 per cent for Prudence Bond and 1.50 per cent for personal pensions.

## Dividends, loans and net cash amounts received from subsidiaries

Under UK company law, dividends can only be paid if a company has distributable reserves sufficient to cover the dividend. In PAC, Prudential s largest operating subsidiary, distributable reserves arise from the emergence of profits from the company s long-term business. For the company s with-profits business the profits reflect the profit transfer to shareholders that occurs upon the declaration of bonuses to policyholders of with-profit products. See Shareholders statutory transfer above. Prudential s insurance and fund management subsidiaries ability to pay dividends and loans to the parent company is restricted by various laws and regulations. Jackson is subject to state laws that limit the dividends payable to its parent company. Dividends in excess of these limitations generally require approval of the state insurance commissioner. The table below shows the dividends, loans and other net cash amounts received by Prudential from the principal operating subsidiaries for 2016 and 2015:

Dividends, loan and net cash amounts received in:	2016 £m	2015 £m
Asia operations	516	467
US operations	420	470
UK Insurance operations (mainly PAC)	300	301
M&G	290	302
Prudential Capital	45	55

Other UK
Total

147
30
1,718
1,625

Each of Prudential s main operations generates sufficient profits to pay dividends to the parent. The amount of dividends paid by the Prudential s main operations is determined after considering the development, growth and investment requirements of the operating businesses. Prudential does not believe that the legal and regulatory restrictions on the ability of any one of its businesses to pay dividends to the parent, constitutes a material limitation on the ability of Prudential plc to meet its cash obligations.

## Liquidity resources and requirements by operating business

## UK life insurance

The liquidity sources for Prudential s UK life insurance businesses comprise premiums, deposits and charges on policies, investment income, proceeds from the sale and maturity of investments, external borrowings and capital

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contributions from the parent company. The liquidity requirements comprise benefits and claims, operating expenses, interest on debt, purchases of investments. Amounts are distributed to the parent company after considering capital requirements.

The liquidity requirements of Prudential s UK life insurance businesses are regularly monitored to match anticipated cash inflows with cash requirements. Cash needs are forecast and projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying these projections are reviewed periodically. Adjustments are made periodically to the investment policies with respect to, among other things, the maturity and risk characteristics of the investment assets to reflect changes in the business—cash needs and also to reflect the changing competitive and economic environment.

The liquidity of Prudential s UK insurance operations is affected by the payment of guaranteed benefits and terminal bonuses on maturing and surrendering policies by the UK insurance operations. In addition, the non-cash bonus declaration to policyholders results in a cash transfer to shareholders funds. A large proportion of Prudential s liabilities contains discretionary surrender values or surrender charges. In addition, pension annuity policies cannot be surrendered by the policyholder.

Further information on the Solvency II capital position of the UK insurance operations as at 31 December 2016 is provided in section II(b) of the Additional Unaudited Financial Information section.

## M&G

The principal liquidity source for M&G is fee income for managing retail, institutional and the internal investment funds of Prudential s UK operations. The principal liquidity requirements are for operating expenses and to meet Client Assets Sourcebook (CASS) requirements. Amounts are distributed to the parent company after considering capital requirements. Capital requirements are driven by fixed operating expenses. As at 31 December 2016, M&G met the relevant regulatory requirements.

## US life insurance

The liquidity sources for Jackson are its cash, short-term investments and publicly traded bonds, premium income deposits received on certain annuity and institutional products, investment income, repurchase agreements, utilisation of a short-term borrowing facility with the Federal Home Loan Bank of Indianapolis and capital contributions from the parent company.

Liquidity requirements are principally for purchases of new investments and businesses, repayment of principal and interest on debt, payments of interest on surplus notes, funding of insurance product liabilities including payments for policy benefits, surrenders, maturities and new policy loans, and funding of expenses including payment of commissions operating expenses and taxes. As at 31 December 2016, Jackson s outstanding notes and bank debt included:

US\$92 million of bank loans from the Federal Home Loan Bank of Indianapolis, collateralised by mortgage-related securities and mortgage loans; and US\$593 million of surplus notes maturing in 2027.

Significant increases in interest rates and disintermediation can create sudden increases in surrender and withdrawal requests by policyholders and contract holders. Other factors that are not directly related to interest rates can also give

rise to disintermediation risk, including but not limited to changes in ratings from rating agencies, general policyholder concerns relating to the life insurance industry (eg the unexpected default of a large, unrelated life insurer) and competition from other products, including non-insurance products such as mutual funds, certificates of deposit and newly developed investment products. Most of the life insurance, annuity and institutional products Jackson offers permit the policyholder or contract holder to withdraw or borrow funds or surrender cash values. At 31 December 2016, a majority of Jackson s fixed annuity reserves include policy restrictions such as surrender charges and market value adjustments to discourage early withdrawal of policy and contract funds.

Jackson uses a variety of asset-liability management techniques to provide for the orderly provision of cash flow from investments and other sources as policies and contracts mature in accordance with their normal terms.

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Jackson s principal sources of liquidity to meet unexpected cash outflows associated with sudden and severe increases in surrenders and withdrawals are its portfolio of liquid assets and its net operating cash flows. As at 31 December 2016, the portfolio of cash, short-term investments and publicly traded bonds and equities amounted to US\$46.3 billion. Operating net cash inflows for Jackson in 2016 were US\$2.8 billion.

As at 31 December 2016, the statutory capital and surplus of Jackson was US\$4.9 billion, which was in excess of the requirements set out under Michigan insurance law. Jackson is also subject to risk-based capital guidelines that provide a method to measure the adjusted capital that a life insurance company should have for regulatory purposes, taking into account the risk characteristics of Jackson s investments and products. As at 31 December 2016, Jackson s total risk based capital ratio under the National Association of Insurance Commissioners definition exceeded the Michigan standards.

#### Asia life insurance

The liquidity sources for Prudential s Asia life insurance businesses comprise premiums, deposits and charges on policies, investment income, proceeds from the sale and maturity of investments, external borrowings and capital contributions from the parent company. The liquidity requirements comprise benefits and claims, operating expenses, interest on debt and purchases of investments. Amounts are distributed to the parent company after considering capital requirements.

The liquidity requirements of Prudential s Asia life insurance businesses are regularly monitored to match anticipated cash inflows with cash requirements. Cash needs are forecast and projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying these projections are reviewed periodically. Adjustments are made periodically to the investment policies with respect to, among other things, the maturity and risk characteristics of the investment assets to reflect changes in the business cash needs and also to reflect the changing competitive and economic environment.

#### **Contractual obligations**

Contractual obligations of the Group with specified payment dates as at 31 December 2016 were as follows:

Less than			More than		
Total	1 year	1-3 years	3-5 years	5 years	
		£m			
508,741	27,792	57,905	57,206	365,838	
6,798	275			6,523	
3,666	1,754	755	156	1,001	
49	3	5	4	37	
412	107	137	72	96	
1,124	989	135			
5,031	5,031				
9,514	9,195	139	95	85	
535,335	45,146	59,076	57,533	373,580	
	Total  508,741 6,798 3,666 49 412 1,124  5,031 9,514	Total         1 year           508,741         27,792           6,798         275           3,666         1,754           49         3           412         107           1,124         989           5,031         5,031           9,514         9,195	Total     1 year     1-3 years       \$508,741     27,792     57,905       6,798     275       3,666     1,754     755       49     3     5       412     107     137       1,124     989     135       5,031     5,031       9,514     9,195     139	Total         1 year         1-3 years         3-5 years           £m         508,741         27,792         57,905         57,206           6,798         275           3,666         1,754         755         156           49         3         5         4           412         107         137         72           1,124         989         135           5,031         5,031         9,195         139         95	

	£m	£m
Reconciliation to consolidated statement of financial position:		
Total contractual obligations per above		535,335
Difference between policyholder liabilities per above (based on undiscounted		
cash flows) and total policyholder liabilities and unallocated surplus of		
with-profits funds per balance sheet:		
Total policyholder liabilities and unallocated surplus of with-profits funds per the		
consolidated statement of financial position	403,313	
Policyholder liabilities (undiscounted) per above	(508,741)	(105,428)
Other short-term/non-contractual obligations:		
Current tax liabilities	649	
Deferred tax liabilities	5,370	
Accruals, deferred income and other creditors (excluding capital and operating		
lease obligations and purchase obligations)	12,236	
Derivative liabilities	3,252	
Liabilities held for sale	4,293	25,800
Other items		124
Total liabilities per consolidated statement of financial position		455,831

#### **Notes**

- (i) Amounts shown in respect of policyholder liabilities represent estimated undiscounted cash flows for Prudential s life assurance contracts. In determining the projected payments, account has been taken of the contract features, in particular that the amount and timing of policyholder benefit payments reflect either surrender, death, or contract maturity. In addition, the undiscounted amounts shown include the expected payments based on assumed future investment returns on assets backing policyholder liabilities. The projected cash flows exclude the unallocated surplus of with-profits funds. As at 31 December 2016, on the IFRS basis of reporting, the unallocated surplus was £14,317 million. The unallocated surplus represents the excess of assets over liabilities, including policyholder asset share liabilities, which reflect the amount payable under the grandfathered realistic Peak 2 reporting regime of the PRA. Although accounted for as a liability, as permitted by IFRS 4, there is currently no expected payment date for the unallocated surplus.
- (ii) The amounts represent the contractual maturity of amounts of borrowings included in the consolidated statement of financial position (i.e. excludes future interest payments) as shown in note C6.2 to Prudential s consolidated financial statements. Long-term debt comprises the core structural borrowings of shareholder-financed operations and the £100 million 8.5 per cent undated subordinated guaranteed bonds of Scottish Amicable Finance plc. Other borrowings comprise operational borrowings attributable to shareholder-financed operations and borrowings attributable to with-profits operations but excluding the £100 million 8.5 per cent undated subordinated guaranteed bonds of Scottish Amicable Finance plc.
- (iii) Comprising unfunded commitments for investments in limited partnerships of £465 million (2015: £299 million) and unfunded commitments related to mortgage loans of £201 million (2015: £64 million) and commitments to purchase or develop investment properties of £458 million (2015: £409 million).
- (iv) Amounts due in less than one year include amounts attributable to unit holders of consolidated unit trusts and similar funds of £8.687 million.

#### Group consolidated cash flows

The discussion that follows is based on the consolidated statement of cash flows prepared under IFRS and presented in the consolidated financial statements of this Form 20-F.

Net cash inflows in 2016 were £1,281 million. This amount comprised inflows of £2,201 million from operating activities less outflows of £349 million from investing activities less outflows of £371 million from financing activities.

Net cash inflows in 2015 were £1,390 million. This amount comprised inflows of £2,533 million from operating activities less outflows of £469 million from investing activities less outflows of £674 million from financing activities.

Net cash outflows in 2014 were £383 million. This amount comprised inflows of £1,828 million from operating activities less outflows of £545 million from investing activities less outflows of £1,666 million from financing activities.

Net cash inflows in 2013 were £789 million. This amount comprised inflows of £1,324 million from operating activities less outflows of £584 million from investing activities plus inflows of £49 million from financing activities.

The Group held cash and cash equivalents of £10,065 million at 31 December 2016 compared with £7,782 million and £6,409 million at 31 December 2015 and 2014, respectively.

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#### **Group Risk Framework**

#### **Risk Management**

#### 1. Introduction

2016 has been a year of extraordinary global change, starting with market turbulence in China, followed by the UK s vote to leave the EU and ending with the election of a new president in the US.

Even in such a year, we have maintained a strong and sustained focus on planning for the possibility of, and ultimately managing, the market volatility and macroeconomic uncertainty arising from these events. Our Risk Management Framework and risk appetite have allowed us to control successfully our risk exposure throughout the year. Our strong governance, processes and controls enable us to deal with the uncertainty ahead in order to continue helping our customers achieve their long-term financial goals.

For our shareholders, we generate value by selectively taking exposure to risks that are adequately rewarded and that can be appropriately quantified and managed. We retain risks within a clearly defined risk appetite, where we believe doing so contributes to value creation and the Group is able to withstand the impact of an adverse outcome. For our retained risks, we ensure that we have the necessary capabilities, expertise, processes and controls to manage appropriately the exposure.

This section explains the main risks inherent in our business and how we manage these evolving risks, with the aim of ensuring we maintain an appropriate risk profile.

#### 2. Risk governance, culture and our risk management cycle

Prudential defines risk as the uncertainty that we face in successfully implementing our strategies and objectives. This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Group. As such, material risks will be retained selectively where we think there is value to do so, and where it is consistent with the Group s risk appetite and philosophy towards risk-taking.

The following section provides more detail on our risk governance, culture and risk management process.

#### a. Risk governance

Our risk governance comprises the organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that the Group head office and the business units establish to make decisions and control their activities on risk-related matters. This encompasses individuals, Group-wide functions and committees involved in the management of risk.

#### i. Risk committees and governance structure

Our Risk governance structure is led by the Group s Risk Committee, supported by independent non-executives on risk committees of major subsidiaries. These committees monitor the development of the risk management framework, the Group s risk appetites, limits, and policies, as well as its risk culture. We have in place a comprehensive risk management cycle to identify, measure, manage and monitor our risk exposures.

In addition to the risk committees mentioned, there are various executive risk forums to ensure risk issues are shared and considered across the Group. These are led by the Group Executive Risk Committee which is supported by a number of specific committees including in relation to security and information security where specialist skills are required.

#### ii. Risk Management Framework

The Group s Risk Management Framework has been developed to monitor and manage the risk of the business at all levels and is owned by the Board. The aggregate Group exposure to the key risk drivers is monitored and managed by the Group Risk function whose responsibility it is to review, assess and report on the Group s risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

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The Framework requires that all our businesses and functions establish processes for identifying, evaluating and managing the key risks faced by the Group the Risk Management Cycle (see below) and is based on the concept of the three lines of defence, comprising risk taking and management, risk control and oversight, and independent assurance.

A major part of the Risk Management Cycle is the annual assessment of the Group s risks which are considered key. These key risks range from risks associated with the economic, market, political and regulatory environment; those that we assume when writing our insurance products and by virtue of the investments we hold; and those that are inherent in our business model and its operation. This is used to inform risk reporting to the risk committees and the Board for the year.

#### iii. Risk appetite, limits and triggers

The extent to which we are willing to take risk in the pursuit of our objective to create shareholder value is defined by a number of risk appetite statements, operationalised through measures such as limits, triggers and indicators. The Group risk appetite is approved by the Board and is set with reference to economic and regulatory capital, liquidity and earnings volatility. The Group risk appetite is aimed at ensuring that we take an appropriate level of aggregate risk and covers all risks to shareholders, including those from participating and third party business. We have no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement and monitor appropriate controls to manage operational risks. Group limits operate within the risk appetite to constrain the material risks, while triggers and indicators provide further constraint and ensure escalation. The Group Chief Risk Officer determines the action to be taken upon any breaches.

The Group Risk function is responsible for reviewing the scope and operation of these measures at least annually, to determine that they remain relevant. The Board approves all changes made to the Group s Risk Appetite Framework. We define and monitor aggregate risk limits based on financial and non-financial stresses for our earnings volatility, liquidity and capital requirements.

#### **Earnings volatility**

The objectives of the aggregate risk limits seek to ensure that:

The volatility of earnings is consistent with the expectations of stakeholders;

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

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

The two measures used to monitor the volatility of earnings are IFRS operating profit and EEV operating profit, although IFRS and EEV total profits are also considered.

### Liquidity

The objective is to ensure that the Group is able to generate sufficient cash resources to meet financial obligations as they fall due in business as usual and stressed scenarios. Risk appetite with respect to liquidity risk is measured using a Liquidity Coverage Ratio which considers the sources of liquidity versus liquidity requirements under stress scenarios.

### Capital requirements

The limits aim to ensure that:

The Group meets its internal economic capital requirements;

The Group achieves its desired target rating to meet its business objectives; and Supervisory intervention is avoided.

The two measures used at the Group level are Solvency II capital requirements and internal economic capital requirements. In addition, capital requirements are monitored on local statutory bases.

The Group Risk Committee is responsible for reviewing the risks inherent in the Group s business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is

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supported by the Group Risk function, which uses submissions from our local business units to calculate the Group s aggregated position (allowing for diversification effects between local business units) relative to the aggregate risk limits.

#### iv. Risk policies

These set out the specific requirements which cover the fundamental principles for risk management within the Group Risk Framework. Policies are designed to give some flexibility so that business users can determine how best to comply with policies based on their local expertise.

There are core risk policies for credit, market, insurance, liquidity and operational risks and a number of internal control policies covering internal model risk, underwriting, dealing controls and tax risk management. They form part of the Group Governance Manual, which was developed to make a key contribution to the sound system of internal control that we maintain in line with the UK Corporate Governance Code and the Hong Kong Code on Corporate Governance Practices. Group Head Office and business units must confirm that they have implemented the necessary controls to evidence compliance with the Group Governance Manual on an annual basis.

#### v. Risk standards

The Group-wide Operating Standards provide supporting detail to the higher level risk policies. In many cases they define the minimum requirements for compliance with Solvency II regulations which in some areas are highly prescriptive. The standards are more detailed than policies.

#### b. Our risk culture

Culture is a strategic priority of the Board who recognise the importance of good culture in the way that we do business. Risk culture is a subset of broader organisational culture, which shapes the organisation-wide values that we use to prioritise risk management behaviours and practices.

An evaluation of risk culture is part of the Risk Management Framework and in particular seeks to identify evidence that:

Senior management in business units articulate the need for good risk management as a way to realise long-term value and continuously support this through their actions.

Employees understand and care about their role in managing risk they are aware of and openly discuss risk as part of the way they perform their role; and

Employees invite open discussion on the approach to the management of risk.

Key aspects of risk culture are also communicated through the Code of Conduct and the policies in the Group Governance Manual, including the commitments to the fair treatment of our customers and staff. The approach to the management of risk is also a key part of the evaluation of the remuneration of executives. Risk culture is an evolving topic across the financial services industry and we will be continuing work to evaluate and embed a strong risk culture through 2017.

#### c. The risk management cycle

The risk management cycle comprises processes to identify, measure and assess, manage and control, and monitor and report on our risks.

#### i. Risk identification

Group-wide risk identification takes place throughout the year, and includes processes such as our Own Risk and Solvency Assessment (ORSA) and the horizon-scanning performed as part of our emerging risk management process.

On an annual basis, a top-down identification of the Group s key risks is performed which considers those risks that have the greatest potential to impact the Group s operating results and financial condition. A bottom-up process of risk identification is performed by the business units who identify, assess and document risks, with appropriate coordination and challenge from the risk functions.

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The Group ORSA report pulls together the analysis performed by a number of risk and capital management processes, which are embedded across the Group, and provides quantitative and qualitative assessments of the Group s risk profile, risk management and solvency needs on a forward-looking basis. The scope of the report covers the full known risk universe of the Group.

Reverse stress testing, which requires us to work backwards from an assumed point of business model failure, is another tool that helps us to identify the key risks and scenarios that may materially impact the Group.

Our emerging risk management process identifies potentially material risks which have a high degree of uncertainty around timing, magnitude and propensity to evolve. The Group holds emerging risk sessions over the year to identify emerging risks which includes input from local subject matter and industry experts. We maintain contacts with thought leaders and peers to benchmark and refine our process.

The risk profile is a key output from the risk identification and risk measurement processes, and is used as a basis for setting Group-wide limits, management information, assessment of solvency needs, and determining appropriate stress and scenario testing. The risk identification processes support the creation of our annual set of key risks, which are then given enhanced management and reporting focus.

#### ii. Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. All quantifiable risks which are material and mitigated by holding capital are modelled in the Group's internal model, which is used to determine capital requirements under Solvency II and our own economic capital basis. Governance arrangements are in place to support the internal model, including independent validation and process and controls around model changes and limitations.

#### iii. Risk management and control

The control procedures and systems established within the Group are designed to manage reasonably the risk of failing to meet business objectives and are detailed in the Group risk policies. This can of course only provide reasonable and not absolute assurance against material misstatement or loss. They focus on aligning the levels of risk taking with the achievement of business objectives.

The management and control of risks are set out in the Group risk policies, and form part of the holistic risk management approach under the Group s ORSA. These risk policies define:

The Group s risk appetite in respect of material risks, and the framework under which the Group s exposure to those risks is limited;

The processes to enable Group senior management to effect the measurement and management of the Group material risk profile in a consistent and coherent way; and

The flows of management information required to support the measurement and management of the Group material risk profile and to meet the needs of external stakeholders.

The methods and risk management tools we employ to mitigate each of our major categories of risks are detailed in section 4 below.

### iv. Risk monitoring and reporting

The identification of the Group s key risks informs the management information received by the Group risk committees and the Board. Risk reporting of key exposures against appetite is also included, as well as ongoing developments in other key and emerging risks.

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#### 3.Summary risks

The table below is a summary of the key risks facing the Group, which can be grouped into those which apply to us because of the global environment in which we operate, and those which arise as a result of the business that we operate including risks arising from our investments, the nature of our products and from our business operations.

#### Macro risks

Some of the risks that we are exposed to are necessarily broad given the external influences which may impact on the Group. These risks include:

Global economic conditions. Changes in global economic conditions can impact us directly; for example by leading to poor returns on our investments and increasing the cost of promises we have made to our customers. They can also have an indirect impact; for example economic pressures could lead to decreased savings, reducing the propensity for people to buy our products. Global economic conditions may also impact on regulatory risk for the Group by changing prevailing political attitudes towards regulation.

**Geopolitical risk.** The geopolitical environment is increasingly uncertain with political upheaval in the UK, the US and the Eurozone. Uncertainty in these regions, combined with conflict in the Middle East and increasing tensions in east Asia underline that geopolitical risks are truly global and their potential impacts are wide-ranging; for example through increased regulatory risk. The geopolitical and economic environments are increasingly closely linked, and changes in the political arena may have direct or indirect impacts on our Group.

**Digital disruption.** The emergence of advance technologies such as artificial intelligence and block chain is providing an impetus for companies to rethink their existing operating models and how they interact with their customers. Prudential is embracing the opportunities presented by digitalisation and is closely monitoring any risks which arise.

#### Risks from our investments

Global economic conditions see above have a large impact on those risks from our investments.

### Risks from our products Insurance risks

The nature of the products offered by the Group exposes it to insurance risks, which are a significant part of our overall risk profile.

## Risks from our business operations Operational risks

As a Group, we are dependent on the appropriate and secure processing of a large number of transactions by our people, IT

Our fund investment performance is a fundamental part of our business in providing appropriate returns for our customers and shareholders, and so is an important area of focus.

#### Credit risk

Is the potential for reduced value of our investments due to the uncertainty around investment returns arising from the potential for defaults of our investment counterparties.

Invested credit risk arises from our asset portfolio. We increase sector focus where necessary.

The assets backing the UK and Jackson s annuity business mean credit risk is a significant focus for the Group.

The insurance risks that we are exposed to by virtue of our products include longevity risk (policyholders living longer than expected); mortality risk (policyholders with life protection dying); morbidity risk (policyholders with health protection becoming ill) and persistency risk (customers lapsing their policies).

From our health protection products, increases in the costs of claims (including the level of medical expenses) increasing over and above price inflation (claim inflation) is another risk.

infrastructure and outsourcing partners, which exposes us to operational risks and reputational risks.

Information security risk is a significant consideration within operational risk, including both the risk of malicious attack on our systems as well as risks relating to data security and integrity and network disruption. The size of Prudential s IT infrastructure and network, our move toward digitisation and the increasing number of high profile cyber security incidents across industries means that this will continue to be an area of high focus.

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#### Market risk

Is the potential for reduced value of our investments resulting from the volatility of asset prices as driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices. In our Asia business, our main market risks arise from the value of fees from our fee-earning products.

In the US, Jackson s fixed and variable annuity books are exposed to a variety of market risks due to the assets backing these policies.

In the UK, exposure relates to the valuation of the proportion of the with-profits fund s future profits which is transferred to the shareholders (future transfers), which is dependent on equity, property and bond values.

M&G invests in a broad range of asset classes and its income is subject to the price volatility of global financial and currency markets.

#### Liquidity risk

Is the risk of not having sufficient liquid assets to meet our obligations as they fall due, and incorporates the risk arising from funds composed of illiquid assets. It results from a mismatch between the liquidity profile of assets and liabilities.

#### 4. Further risk information

The processes that determine the price of our products and reporting the results of our long-term business operations require us to make a number of assumptions. Where experience deviates from these assumptions our profitability may be impacted.

Across our business units, persistency and morbidity risks are among the largest insurance risks for our Asia business given our strong focus on health protection products in the region.

For the UK and Jackson, the most significant insurance risk is longevity risk driven by their annuity businesses.

#### Regulatory risk

We also operate under the ever-evolving requirements set out by diverse regulatory and legal regimes (including tax), as well as utilising a significant number of third parties to distribute products and to support business operations; all of which add to the complexity of the operating model if not properly managed.

The number of regulatory changes under way across Asia, in particular those focusing on consumer protection means that regulatory change in the region is also considered a key risk.

Both Jackson and the UK operate in highly regulated markets. Regulatory reforms could materially impact our businesses, and regulatory focus continues to be high.

In reading the sections below, it is useful to understand that there are some risks that our policyholders assume by virtue of the nature of their products, and some risks that the Company and its shareholders assume. Examples of the latter include those risks arising from assets held directly by and for the Company or the risk that policyholder funds are exhausted. This report is focused mainly on risks to the shareholder, but will include those which arise indirectly through our policyholder exposures.

#### 4.1 Risks from our investments

#### a. Market risk

The main drivers of market risk in the Group are:

Investment risk (including equity and property risk);

Interest rate risk; and

Given the geographical diversity of our business, foreign exchange risk.

With respect to investment risk, equity and property risk arises from our holdings of equity and property investments, the prices of which can change depending on market conditions.

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The valuation of our assets (particularly the bonds that we invest in) and liabilities are also dependent on market interest rates and exposes us to the risk of those moving in a way that is detrimental for us.

Given our global business, we earn our profits and hold assets in various currencies. The translation of those into our reporting currency exposes us to movements in foreign exchange rates.

Our main investment risk exposure arises from the portion of the profits from the UK with-profits fund to which we are entitled to receive; the value of the future fees from our fee-earning products in our Asia business; and from the asset returns backing Jackson s variable annuities business.

Our interest rate risk is driven in the UK by our need to match our assets and liabilities; from the guarantees of some non unit-linked investment products in Asia; and the cost of guarantees in Jackson s fixed, fixed index and variable annuity business.

The methods that we use to manage and mitigate our market risks include the following:

Our market risk policy;

Risk appetite statements, limits and triggers that we have in place;

The monitoring and oversight of market risks through the regular reporting of management information;

Our asset and liability management programmes;

Use of derivative programmes, including, for example, interest rate swaps, options and hybrid options for interest rate risk;

Regular deep dive assessments; and

Use of currency hedging.

#### Investment risk

(Audited)

In the UK business, our main investment risk arises from the assets held in the with-profits funds. Although this is mainly held by our policyholders, a proportion of the fund s profit (one tenth) is transferred to us and so our investment exposure relates to the future valuation of that proportion (future transfers). This investment risk is driven mainly by equities in the fund, although there is some risk associated with other investments such as property and bonds. Some hedging to protect from a reduction in the value of these future transfers against falls in equity prices is performed outside the fund using derivatives. The with-profits funds large Solvency II own funds estimated at £8.4 billion as at 31 December 2016 (31 December 2015: £7.6 billion) helps to protect against market fluctuations and helps the fund to maintain appropriate solvency levels. The with-profits funds Solvency II own funds are partially protected against falls in equity markets through an active hedging programme within the fund.

In Asia, our shareholder exposure to equity price movements results from unit-linked products, where our fee income is linked to the market value of the funds under management. Further exposure arises from with-profits businesses where bonuses declared are broadly based on historical and current rates of return on equity.

In Jackson, investment risk arises from the assets backing customer policies. In the case of spread-based business, including fixed annuities, these assets are generally bonds, and shareholder exposure comes from the minimum returns needed to meet the guaranteed rates that we offer to policyholders. For our variable annuity business, these assets include both equities and bonds. In this case, the main risk to the shareholder comes from the guaranteed benefits that can be included as part of these products. Our exposure to this kind of situation is reduced by using a derivative hedging programme, as well as through the use of reinsurance to pass on the risk to third party reinsurers.

### Interest rate risk

(Audited)

While long-term interest rates in advanced economies have broadly increased since mid-2016, they remain close to historical lows. Some products that we offer are sensitive to movements in interest rates. We have already taken a number of actions to reduce the risk to the in-force business, as well as re-pricing and restructuring new business offerings in response to these historically low interest rates. Nevertheless, we still retain some sensitivity to interest rate movements.

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Interest rate risk arises in our UK business from the need to match cash payments to meet annuity obligations with the cash we receive from our investments. To minimise the impact on our profit, we aim to match the duration (a measure of interest rate sensitivity) of assets and liabilities as closely as possible and the position is monitored regularly. Under the Solvency II regulatory regime, additional interest rate risk results from the way the balance sheet is constructed, such as the requirement for us to include a risk margin. The UK business continually assesses the need for any derivatives in managing its interest rate sensitivity. The with-profits business is exposed to interest rate risk because of underlying guarantees in some of its products. Such risk is largely borne by the with-profits fund itself but shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

In Asia, our exposure to interest rate risk arises from the guarantees of some non unit-linked investment products. This exposure exists because it may not be possible to hold assets which will provide cash payments to us which match exactly those payments we in turn need to make to policyholders this is known as an asset and liability mismatch and although it is small and appropriately managed, it cannot be eliminated.

Jackson is exposed to interest rate risk in its fixed, fixed index and variable annuity books. Movements in interest rates can impact on the cost of guarantees in these products, in particular the cost of guarantees may increase when interest rates fall. We actively monitor the level of sales of variable annuity products with guaranteed living benefits, and together with the risk limits we have in place this helps us to ensure that we are comfortable with the interest rate and market risks we incur as a result. The Jackson hedging programme in place includes hybrid derivatives to protect us from a combined fall in interest rates and equity markets since Jackson is exposed to the combination of these market movements.

### Foreign exchange risk

(Audited)

The geographical diversity of our businesses means that we have some exposure to the risk of exchange rate fluctuations. Our operations in the US and Asia, which represent a large proportion of our operating profit and shareholders—funds, generally write policies and invest in assets in local currencies. Although this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in our Group financial statements when results are reported in UK sterling.

We retain revenues locally to support the growth of our business and capital is held in the local currency of the business to meet local regulatory and market requirements. We accept the foreign exchange risk this can produce when reporting our Group balance sheet and income statement. In cases where a surplus arises in an overseas operation which is to be used to support Group capital, or where a significant cash payment is due from an overseas subsidiary to the Group, this foreign exchange exposure is hedged where we believe it is economically favourable to do so. Generally, we do not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside local territories, but we do have some controlled appetite for this on fee income and on non-sterling investments within the with-profits fund. Where foreign exchange risk arises outside our appetite, currency borrowings, swaps and other derivatives are used to manage our exposure.

#### b. Credit risk

We invest in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments we need to make to policyholders. We also enter into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, we are exposed to credit

risk and counterparty risk across our business.

Credit risk is the potential for reduction in the value of our investments which results from the perceived level of risk of an investment issuer being unable to meet its obligations (defaulting). Counterparty risk is a type of credit risk and relates to the risk that the counterparty to any contract we enter into being unable to meet their obligations causing us to suffer loss.

We use a number of risk management tools to manage and mitigate this credit risk, including the following:

Our credit risk policy;

Risk appetite statements and limits that we have defined on issuers, counterparties and the average credit quality of the portfolio;

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Collateral arrangements we have in place for derivative transactions;

The Group Credit Risk Committee s oversight of credit and counterparty credit risk and sector and/or name-specific reviews. During 2016, it has conducted sector reviews in the banking (UK and Asia) and energy sectors;

Regular deep dive assessments; and

Close monitoring or restrictions on investments that may be of concern.

#### Debt and loan portfolio

(Audited)

Our UK business is mainly exposed to credit risk on fixed income assets in the shareholder-backed portfolio. At 31 December 2016, this portfolio contained fixed income assets worth £35.6 billion. Credit risk arising from a further £55.2 billion of fixed income assets is largely borne by the with-profits fund, to which the shareholder is not directly exposed although under extreme circumstances shareholder support may be required if the fund is unable to meet payments as they fall due.

The value of our debt portfolio in our Asia business was £36.5 billion at 31 December 2016. The majority (69 per cent) of the portfolio is in unit-linked and with-profits funds and so exposure of the shareholder to this component is minimal. The remaining 31 per cent of the debt portfolio is held to back the shareholder business.

Credit risk also arises in the general account of the Jackson business, where £40.7 billion of fixed income assets are held to support shareholder liabilities including those from our fixed annuities, fixed index annuities and life insurance products.

The shareholder-owned debt and loan portfolio of the Group s asset management business of £2.4 billion as at 31 December 2016 mostly belongs to our Prudential Capital (PruCap) operations.

Certain sectors have been under pressure during 2016, including the European banking sector. Most of the focus on the latter was around UK banks due to Brexit concerns, Italian banks and certain banks at risk of fines for the mis-selling of mortgage securities leading up to the 2008 financial crisis. We subject these sectors to ongoing monitoring and regular management information reporting to the Group s risk committees. Certain sectors are also subject to our watch list and early warning indicator monitoring processes.

Further details of the composition and quality of our debt portfolio, and exposure to loans, can be found in the IFRS financial statements.

#### Group sovereign debt

(Audited)

We also invest in bonds issued by national governments, that are traditionally seen as safer investments. This sovereign debt represented 19 per cent or £17.1 billion of the shareholder debt portfolio as at 31 December 2016 (31 December 2015: 17 per cent or £12.8 billion). 4 per cent of this was rated AAA and 92 per cent was considered investment grade (31 December 2015: 94 per cent investment grade). At 31 December 2016, the Group s shareholder holding in Eurozone sovereign debt was £767 million. 75 per cent of this was rated AAA (31 December 2015: 75 per cent rated AAA). We do not have any sovereign debt investments in Greece.

The particular risks associated with holding sovereign debt are detailed further in our disclosures on risk factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 31 December 2016 are given in Note C3.2(f) of the Group s IFRS financial statements.

### Bank debt exposure and counterparty credit risk

(Audited)

Our exposure to banks is a key part of our core investment business, as well as being important for the hedging and other activities we undertake to manage our various financial risks. Given the importance of our relationship with our banks, exposure to the sector is a considered a key risk for the Group with an appropriate level of management information provided to the Group s risk committees and the Board.

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The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 31 December 2016 are given in Note C3.2(f) of the Group s IFRS financial statements.

Our exposure to derivative counterparty and reinsurance counterparty credit risk is managed using an array of risk management tools, including a comprehensive system of limits.

Where appropriate, we reduce our exposure, buy credit protection or use additional collateral arrangements to manage our levels of counterparty credit risk.

At December 2016, shareholder exposures by rating and sector are shown below:

96 per cent of the shareholder portfolio is investment grade rated. In particular, 68 per cent of the portfolio is rated A- and above; and

The Group s shareholder portfolio is well diversified: no individual sector makes up more than 10 per cent of the total portfolio (excluding the financial and sovereign sectors).

#### c. Liquidity risk

Our liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due. This incorporates the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or redemption requests are made against Prudential issued illiquid funds.

We have significant internal sources of liquidity, which are sufficient to meet all of our expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external sources of funding. In total, the Group has £2.6 billion of undrawn committed facilities that we can make use of, expiring in 2020. We have access to further liquidity by way of the debt capital markets, and also have in place an unlimited commercial paper programme and have maintained a consistent presence as an issuer in this market for the last decade.

Liquidity uses and sources are assessed at a Group and business unit level under both base case and stressed assumptions. We calculate a Liquidity Coverage Ratio (LCR) under stress scenarios as one measure of our liquidity risk, and this ratio and the liquidity resources available to us are regularly monitored and are assessed to be sufficient.

Our risk management and mitigation of liquidity risk include:

Our liquidity risk policy;

The risk appetite statements, limits and triggers that we have in place;

The monitoring of liquidity risk we perform through regular management information to committees and the Board;

Our Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as gap analysis of our liquidity risks and the adequacy of our available liquidity resources under normal and stressed conditions;

Regular stress testing;

Our established contingency plans and identified sources of liquidity;

Our ability to access the money and debt capital markets;

Regular deep dive assessments; and

The access we enjoy to external sources of finance through committed credit facilities.

### 4.2 Risks from our products

#### a. Insurance risk

Insurance risk makes up a significant proportion of our overall risk exposure. The profitability of our businesses depends on a mix of factors including levels of, and trends in, mortality (policyholders dying), morbidity (policyholders becoming ill) and persistency (customers lapsing their policies), and increases in the costs of claims, including the level of medical expenses increases over and above price inflation (claim inflation).

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The key drivers of the Group s insurance risks are persistency and morbidity risk in the Asia business; and longevity risk in the Jackson and Prudential UK & Europe businesses.

We manage and mitigate our insurance risk using the following:

Our insurance and underwriting risk policies;

The risk appetite statements, limits and triggers we have in place;

Using longevity, morbidity and persistency assumptions that reflect recent experience and expectation of future trends, and industry data and expert judgement where appropriate;

We use reinsurance to mitigate longevity and morbidity risks;

Morbidity risk is also mitigated by appropriate underwriting when policies are issued and claims are received; Persistency risk is mitigated through the quality of sales processes and with initiatives to increase customer retention;

Medical expense inflation risk mitigated through product re-pricing; and

Regular deep dive assessments.

Longevity risk is an important element of our insurance risks for which we need to hold a large amount of capital under Solvency II regulations. Longevity reinsurance is a key tool for us in managing our risk. The enhanced pensions freedoms introduced in the UK during 2015 greatly reduced the demand for retail annuities and further liberalisation is anticipated. Although we have scaled down our participation in the annuity market by reducing new business acquisition, given our significant annuity portfolio the assumptions we make about future rates of improvement in mortality rates remain key to the measurement of our insurance liabilities and to our assessment of any reinsurance transactions.

We continue to conduct research into longevity risk using both experience from our annuity portfolio and industry data. Although the general consensus in recent years is that people are living longer, there is considerable volatility in year-on-year longevity experience, which is why we need expert judgement in setting our longevity basis.

Our morbidity risk is mitigated by appropriate underwriting when policies are issued and claims are received. Our morbidity assumptions reflect our recent experience and expectation of future trends for each relevant line of business.

In Asia, we write significant volumes of health protection business, and so a key assumption for us is the rate of medical inflation, which is often in excess of general price inflation. There is a risk that the expenses of medical treatment increase more than we expect, so the medical claim cost passed on to us is higher than anticipated. Medical expense inflation risk is best mitigated by retaining the right to re-price our products each year and by having suitable overall claim limits within our policies, either limits per type of claim or in total across a policy.

Our persistency assumptions similarly reflect a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. Persistency risk is mitigated by appropriate training and sales processes and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, we make allowance for the relationship (either assumed or historically observed) between persistency and investment returns and account for the resulting additional risk. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products. The effect of persistency on our financial results can vary but mostly depends on the value of the product features and market conditions.

### 4.3 Risks from our business operations

### a. Operational risk

Operational risk is the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel and systems, or from external events. This includes employee error, model error, system failures, fraud or some other event which disrupts business processes.

We manage and mitigate our operational risk using the following:

Operational risk and outsourcing and third-party supply policies; Corporate insurance programmes to limit the impact of operational risks;

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Scenario analysis for operational risk capital requirements, which focus on extreme, yet plausible, events; Internal and external review of cyber security capability; and

Regular testing of elements of the disaster-recovery plan.

An important element of operational risk relates to compliance with changing regulatory requirements. The high rate of global regulatory change, in an already complex regulatory landscape, increases the risk of non-compliance due to a failure to identify, correctly interpret, implement and/or monitor regulations. Legislative developments over recent years, together with enhanced regulatory oversight and increased capability to issue sanctions, have resulted in a complex regulatory environment that may lead to breaches of varying magnitude if the Group s business-as-usual operations are not compliant. As well as prudential regulation, we focus on conduct regulation, including regulations related to anti-money laundering, bribery and corruption, and sales practices. We have a particular focus on these regulations in newer/emerging markets.

The performance of core activities places reliance on the IT infrastructure that supports day-to-day transaction processing. Our IT environment must also be secure and we must address an increasing cyber risk threat as our digital footprint increases—see separate Cyber risk section below. The risk that our IT infrastructure does not meet these requirements is a key area of focus, particularly the risk that legacy IT infrastructure supporting core activities/processes affects business continuity or impacts on business growth.

As well as the above, other key areas of focus within operational risk include:

The risk of a significant failure of a third-party outsourcing partner impacting critical services;

The risk of trading or transaction errors having a material cost across Group;

The risk that errors within models and user-developed applications used by the Group result in incorrect or inappropriate transactions being instructed;

Departure of key persons or teams resulting in disruption to current and planned business activities;

The risk that key people, processes and systems are unable to operate (thus impacting on the on-going operation of the business) due to a significant unexpected external event; for example pandemic, terrorist attack, natural disaster or political unrest;

The risk that a significant project fails or partially fails to meet its objectives, leading to financial loss; and The risk of inadequate or inappropriate controls, governance structures or communication channels in place to support the desired culture and ensure that the business is managed in line with the core business values, within the established risk appetite and in alignment with external stakeholder expectations.

### b. Global regulatory and political risk

Our risk management and mitigation of regulatory and political risk includes the following:

A Risk and Capital Plan that includes considerations of current strategies;

Close monitoring and assessment of our business environment and strategic risks;

Board strategy sessions that consider risk themes;

A Systemic Risk Management Plan that details the Group s strategy and Risk Management Framework; and

A Recovery Plan covering corporate and risk governance for managing risks in a distressed environment, a range of recovery options, and scenarios to assess the effectiveness of these recovery options

In June 2016, the UK voted to leave the EU. The potential outcome of the negotiations on UK withdrawal and any subsequent negotiations on trade and access to major trading markets, including the single EU market, is currently highly uncertain.

The ongoing uncertainty and likelihood of a lengthy negotiation period may increase volatility in the markets where we operate, creating the potential for a general downturn in economic activity and for further or prolonged falls in interest rates in some jurisdictions due to easing of monetary policy and investor sentiment. We have several UK-domiciled operations, including Prudential UK and M&G, and these may be impacted by a UK withdrawal from the EU. However, our diversification by geography, currency, product and distribution should reduce some of the potential impact. Contingency plans were developed ahead of the referendum by business units and operations that may be immediately impacted by a vote to withdraw the UK from the EU, and these plans have been enacted since the referendum result.

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The EU s Solvency II Directive came into effect on 1 January 2016; however, the UK s vote to leave the EU has the potential to result in changes to future applicability of the regime in the UK. In September 2016, following the Brexit vote, the UK Treasury published terms of reference of its consultation into Solvency II to consider the options for British insurers and to assess the impact of the regime on the competitiveness of the UK insurance industry, the needs of UK consumers and the wider UK business economy. The outcome is likely to be dependent on the overall Brexit agreement reached between the UK and EU. Separately, the European Commission has commenced a review of some elements of the application of the Solvency II legislation with a particular focus on the Solvency Capital Requirement calculated using the standard formula.

National and regional efforts to curb systemic risk and promote financial stability are also underway in certain jurisdictions in which Prudential operates, including the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US, and other European Union legislation related to the financial services industry.

There are a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way Prudential is supervised. These include addressing Financial Conduct Authority (FCA) reviews, ongoing engagement with the Prudential Regulation Authority (PRA), and the work of the Financial Stability Board (FSB) and standard-setting institutions such as the International Association of Insurance Supervisors (IAIS). Decisions taken by regulators, including those related to solvency requirements and capital allocation may have an impact on our business.

The IAIS s Global Systematically Important Insurers (G-SII) regime form additional compliance considerations for us. Groups designated as G-SIIs are subject to additional regulatory requirements, including enhanced group-wide supervision, effective resolution planning, development of a Systemic Risk Management Plan, a Recovery Plan and a Liquidity Risk Management Plan. Prudential s designation as a G-SII was reaffirmed by the IAIS in November 2016, based on the updated methodology published in June 2016. Prudential is monitoring the development and potential impact of the policy measures and is continuing to engage with the PRA on the implications of the policy measures and Prudential s designation as a G-SII. We continue to engage with the IAIS on developments in capital requirements for groups with G-SII designation.

The IAIS is also developing a Common Framework (ComFrame) which is focused on the supervision of Internationally Active Insurance Groups. ComFrame will establish a set of common principles and standards designed to assist regulators in addressing risks that arise from insurance groups with operations in multiple jurisdictions. As part of this, work is underway to develop a global Insurance Capital Standard that is intended to apply to Internationally Active Insurance Groups. Once the development of the Insurance Capital Standard (ICS) has been concluded, it is intended to replace the Basic Capital Requirement as the minimum group capital requirement for G-SIIs.

A consultation on the ICS was concluded in 2016 and the IAIS intends to publish an interim version of ICS in 2017. Further field testing, consultations and private reporting to group-wide supervisors on the interim version of the ICS are expected over the coming years. It is currently planned to be adopted as part of ComFrame by the IAIS in late 2019.

The IAIS s Insurance Core Principles, which provide a globally-accepted framework for the supervision of the insurance sector and ComFrame evolution, are expected to create continued development in both prudential and conduct regulations over the next two to three years.

In the US, the Department of Labor proposal in April 2016 to introduce new fiduciary obligations for distributors of investment products to holders of regulated accounts, which could dramatically reshape the distribution of retirement

products. Jackson s strong relationships with distributors, history of product innovation and efficient operations should help mitigate any impacts.

The US National Association of Insurance Commissioners (NAIC) is currently conducting an industry consultation with the aim of reducing the complexity in the variable annuity statutory balance sheet and risk management. Following an industry quantitative impact study, changes have been proposed to the current framework; however, these are considered to be at an early stage of development. Jackson continues to be engaged in the consultation and testing process. The proposal is currently planned to be effective from 2018.

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With the new US administration having taken office in January 2017, the potential uncertainty as to the timetable and status of these key US reforms has increased given preliminary indications from Washington. Our preparations to manage the impact of these reforms will continue until further clarification is provided.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New requirements could be introduced in these and other regulatory regimes that challenge legal structures, current sales practices.

#### c. Cyber risk

Cyber risk is an area of increased scrutiny for global regulators after a number of recent high profile attacks and data losses. The growing maturity and industrialisation of cyber-criminal capability, together with an increasing level of understanding of complex financial transactions by criminal groups, are two reasons why risks to the financial services industry are increasing.

Given this, cyber security is seen as a key risk for the Group. Our current threat assessment is that, while we are not individually viewed as a compelling target for a direct cyber-attack, we are at risk of suffering attacks as a member of the global financial services industry, with potentially significant impact on business continuity, our customer relationship and our brand reputation.

The Board receives periodic updates on cyber risk management throughout the year. The current Group-wide Cyber Risk Management Strategy and the associated Group-wide Coordinated Cyber Defence Plan were approved by the Board in 2016.

The Cyber Risk Management Strategy includes three core objectives: to develop a comprehensive situational awareness of our business in cyberspace, to pro-actively engage cyber attackers to minimise harm to our business and to enable the business to grow confidently and safely in cyberspace.

The Cyber Defence Plan consists of a number of work-streams, including developing our ability to deal with incidents; alignment with our digital transformation strategy; and increasing cyber oversight and assurance to the Board.

Protecting our customers remains core to our business, and the successful delivery of the Cyber Defence Plan will reinforce our capabilities to continue doing so in cyberspace as we transition to a digital business.

Group functions work with each of the business units to address cyber risks locally within the national and regional context of each business, following the strategic direction laid out in the Cyber Risk Management Strategy and managed through the execution of the Cyber Defence Plan.

The Group Information Security Committee, which consists of senior executives from each of the businesses and meets on a regular basis, governs the execution of the Cyber Defence Plan and reports on delivery and cyber risks to the Group Executive Risk Committee. Both committees also receive regular operational management information on the performance of controls.

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Excludes Group s proportionate share in joint ventures and unit-linked assets and holdings of consolidated unit trust and similar funds.

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#### SUPERVISION AND REGULATION OF PRUDENTIAL

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

#### **Group Supervision**

The Prudential Regulation Authority (PRA) is Prudential Group s lead supervisor, with a key focus on solvency and financial soundness.

The regulators supervising the Group do so on a cross-border basis through a regulatory college . The college meets at an annual event hosted by the PRA and includes a number of non-UK regulators who supervise Prudential s overseas operations, as well as representatives from the Financial Conduct Authority (FCA) and European Insurance and Occupational Pensions Authority (EIOPA).

### **Global Regulatory Developments and Trends**

There are a number of ongoing policy initiatives and regulatory developments at a global level that are having, and will continue to have, an impact on the way Prudential is supervised. These include the work of the Financial Stability Board (FSB) (an international body established to coordinate, develop and promote effective regulatory, supervisory and other financial sector policies in the interests of financial stability) and the work of standard-setting institutions such as the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO).

Since 2010, the IAIS, under the auspices of the FSB and G20, has been developing two regulatory frameworks for Group-wide insurance supervision. The first, is a set of rules that apply to Global Systemically Important Insurers (G-SIIs) and impose additional regulatory requirements such as enhanced group-wide supervision, resolution planning and development of a Systemic Risk Management Plan, a Recovery Plan and a Liquidity Risk Plan. The IAIS has the responsibility for determining the methodology for designating G-SIIs. The second, ComFrame, or the Common Framework, is a harmonised set of rules for the supervision of internationally active insurance groups (IAIGs). Under ComFrame, the IAIS is currently developing its risk-based global insurance capital standard (ICS). Both sets of rules are intended to increase oversight of insurance groups and enhance capital rules in an attempt to reduce systemic risk. Prudential was reaffirmed as a G-SII on 21 November 2016, and will be subjected to ComFrame standards.

The European Union s Solvency II Directive came into effect on 1 January 2016, however the future application of the Solvency II regime to UK insurers remains uncertain following the UK s decision to leave the EU. A series of reviews of the Solvency II Directive are scheduled between 2016 and 2021. It remains unclear what regime will be in place for UK insurers following Brexit.

### **UK Supervision and Regulation**

#### The Financial Services and Markets Act 2000

Prudential s insurance and investment businesses in the UK are regulated under the Financial Services and Markets Act 2000 (FSMA 2000), as amended by the Financial Services Act (FS Act ) 2012, the Financial Services (Banking Reform) Act 2013 and other legislation. In addition, those businesses are subject to various UK laws (for example, the Data Protection Act 1998 in relation to the processing of customer data and various Pension Acts), some of which

require the relevant Prudential entity to be licensed or registered.

### UK regulatory regime

There are two principal financial services regulators in the UK:

The PRA, which oversees macro-prudential regulation of deposit-takers, insurers and a small number of systemically important investment firms.

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The FCA, which is responsible for conduct of business regulation of all authorised firms and the prudential regulation of firms not regulated by the PRA.

In discharging their respective functions, the PRA and FCA have separate objectives as defined in FSMA 2000 (as amended by the FS Act). The general objective of the PRA is to promote the safety and soundness of the firms it regulates. The PRA also has an insurance objective, which is to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders. The strategic objective of the FCA is to ensure that the relevant markets that it regulates function properly. The FCA is responsible for the regulation of conduct in retail, as well as wholesale financial markets and the infrastructure that supports those markets. The FCA has three operational objectives: to secure an appropriate degree of protection for consumers; to protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers.

### The approach of the PRA and FCA

Most of Prudential s subsidiaries that carry on insurance business in the UK, including The Prudential Assurance Company Limited (PAC) and Prudential Pensions Limited are dual-regulated firms, meaning they are regulated by the PRA for prudential purposes and by the FCA for conduct purposes. The exceptions are Prudential Distribution Limited and Prudential Financial Planning Limited, which are regulated by the FCA only due to their business model.

Close and regular contact between the PRA and FCA and senior managers remains a feature of the UK regulatory regime. Both regulators have continued to focus on risk and governance frameworks although pursued through distinct supervisory programmes.

Both the PRA and FCA weight their supervisory activity towards those issues and those insurers that, in their judgment, pose the greatest risk to their respective statutory objectives, conducting assessments on a continuous cycle. For significant firms such as Prudential, the PRA conducts an annual detailed business model analysis which (in the case of an insurer) encompasses formulating a projection of an insurer s ability to generate returns, and any associated risks. The PRA may require the insurer to change its business model if it believes that mitigating measures alone cannot adequately reduce material risks to safety and soundness and policyholder protection.

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

#### Principles for Businesses and Fundamental Rules

An authorised firm is subject to a range of ongoing regulatory requirements supervised by the FCA. Dual-regulated firms are supervised by the PRA. Two of the fundamental requirements that must be met at all times are to ensure that the firm has adequate resources to carry on its business, and to meet Fit and Proper requirements. Key features of the respective regulatory requirements are the FCA s 11 Principles for Businesses and the PRA s 8 Fundamental Rules . These cover key areas such as the firm s relationship with the FCA and PRA, the need to conduct business with integrity and the requirement to pay due regard to the interests of customers and treat them fairly.

### Individual Accountability

The new Senior Insurance Managers Regime (SIMR) has applied since 7 March 2016. It is broadly in line with the regime implemented for the banking sector in the UK, but with some differences which arise from Solvency II systems of governance requirements. The SIMR replaced the approved persons regime previously in place for insurance firms, and brings extra emphasis on the conduct of senior managers and their individual responsibility for decisions. This new emphasis on senior executive conduct and accountability allows the PRA to subject any firm that fails to uphold the new requirements to regulatory censure. Senior managers have core responsibilities prescribed to

them, according to their role.

The PRA and FCA have signalled their intention to extend the current banking Senior Managers Regime (SMR) to all financial services institutions by 2018.

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### Capital requirements for insurers

As noted above, in order to maintain authorised status under the FSMA 2000, firms must continue to satisfy certain threshold conditions which, *inter alia*, require firms to have adequate resources for the carrying on of their business. The majority of the rules which govern the prudential regulation of insurers are currently found in the Minimum Capital Requirement , Own Funds and Solvency Capital Requirement parts of the PRA Rulebook, which came into force on 1 January 2016 as part of the implementation of Solvency II.

Solvency II s main aim is to ensure the financial stability of the insurance industry and protect policyholders through revised solvency requirements which are better matched to the true risks of the business. The framework is outlined in the Solvency II Directive, with much of the detail in the rules set out in Level 2 implementing measures. These measures are accompanied by further requirements developed by EIOPA, namely, the Implementing Technical Standards (which aim to ensure the uniform application of the Solvency II Directive) and Guidelines necessary to guarantee convergence of the Solvency II implementation.

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

The regime also requires firms to disclose a considerably greater level of qualitative and quantitative information, both to their own supervisor through Regular Supervisory Reporting (RSR) and to the market through the publication of a Solvency and Financial Condition Report (SFCR). This is intended to increase transparency, allowing easier comparison across the industry and enabling supervisors to identify if firms are heading for financial difficulty at an earlier stage.

Further details on the Group Solvency II capital position at 31 December 2016 are set out in the Capital Position section within Overview of 2016 Financial Performance.

### Conduct of Business Rules

The FCA s Conduct of Business Rules (and, for insurers, the FCA s Insurance Conduct of Business Rules) stipulate the day-to-day standards that should be observed by authorised persons when carrying on regulated activities.

The scope and range of obligations imposed on an authorised firm under these Rules varies according to its business and the range of its clients. Generally, the obligations imposed on an authorised firm include the need to categorise its clients according to their level of sophistication, provide them with information about the firm, meet certain standards of product disclosure, ensure that promotional materials which it produces are clear, fair and not misleading, assess suitability when advising on certain products, manage conflicts of interest, report appropriately to its clients and provide certain protections in relation to client assets. Additional details of relevance to the insurance and investment businesses are discussed below.

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

### Financial Advice and Fairness

In March 2016, HM Treasury and the FCA published their final report setting out 28 recommendations to increase the accessibility and affordability of the advice and guidance that consumers receive in the UK. This followed the 2015 launch of the Financial Advice Market Review (FAMR), which was intended to consider the current regulatory and legal frameworks governing the provision of financial advice to consumers, and its effectiveness in ensuring that all consumers have access to the information, advice and guidance necessary to enable them to make effective decisions about their finances.

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This review considered all types of retail financial products including pensions, savings, mortgages and insurance. The recommendations focus on three key areas:

Affordability: advice and guidance to the mass market should be more cost-effective. Firms should develop more streamlined services and engage with customers in a more effective way. There is a proposal for the FCA to set up a dedicated team to help firms develop large-scale automated advice models to bring these services to market more quickly

Accessibility: implementing procedures to help consumers engage more effectively with advice. These include making consumers—own information more easily available to them and those who advise them; the development of rules of thumb—and the use of nudges to encourage customers to seek support at key life stages. The report also recommends measures to help employers to give more support to their staff on financial matters

Liabilities and consumer redress: recommendations to increase clarity and transparency about the way in which the Financial Ombudsman Service deals with consumer complaints. The report also makes recommendations in relation to the FCA—s review of funding of the Financial Services Compensation Scheme to assist advisers struggling to predict and budget for the levy they have to pay.

The FCA announced in 2014 that it would assess whether life insurance firms are operating historic (often termed legacy or heritage) products in a fair manner. For example, the project assessed:

whether firms strategies towards these business lines adequately consider the fair treatment of customers; to what extent firms review legacy products to ascertain whether they remain fit for purpose whether customers receive appropriate information about policy benefits the causes of poor fund performance and whether apportionment of costs and expenses to these products is fair the nature and extent of discontinuance charges that potentially inhibit customers from switching to better performing products.

On 3 March 2016, the FCA published a report setting out its findings from the above thematic review covering eleven firms, including Prudential s UK business. In December 2016, and in view of feedback on the conclusions of the thematic review, the FCA issued a further report which provided guidance on the actions that relevant firms should undertake in order to ensure fair treatment of closed-book customers.

On 14 October 2016, the FCA published their findings following the conclusion of the Thematic Review of Non-Advised Annuity Sales Practices. The FCA wanted to establish whether firms provided customers with sufficient information about enhanced annuities. In conjunction with this, Prudential has agreed with the FCA to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review will examine whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. The review is expected to commence in 2017 and last a period of three years. A provision of £175 million has been established at 31 December 2016 to cover the costs of undertaking the review and any potential redress. The ultimate amount that will be expended by the Group on the review remains uncertain. Although the Group s professional indemnity insurance may mitigate the overall financial impact of this review with potential insurance recoveries of up to £175 million, no such recovery has been factored in the provision, in accordance with the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Consumer protection, the Financial Ombudsman Service ( FOS ), the Financial Services Compensation Scheme ( FSCS ) and the Pension Protection Fund ( PPF )

Authorised firms must have appropriate complaints handling procedures, the standards for which are defined in the FCA Handbook. However, once these procedures have been exhausted, qualifying complainants may turn to the FOS. The Ombudsman is empowered to order firms to pay fair compensation for loss and damage and may order a firm to

take such steps as the Ombudsman determines to be just and appropriate in order to remedy a complaint. The actual level of compensation customers receive will depend on the basis of their claim. The FSCS only pays compensation for financial loss.

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The FSCS is intended to compensate individuals and other groups of eligible claimants , including certain trustees for claims against an authorised firm where the authorised firm is unable or unlikely to be able to meet those claims (generally, when it is insolvent or has gone out of business). Both the PRA and the FCA have rule-making powers for the FSCS, and the FSCS is accountable to both regulators.

In addition, the PPF is a statutory fund aimed at protecting members of eligible pension schemes where their employer (or a past employer) has become insolvent and the pension scheme can no longer afford to pay the promised pension.

All the above schemes are funded by levies on the UK financial services industry.

### **Financial Crime**

The prevention of financial crime is a key element of the FCA s statutory remit to protect the integrity of the UK financial system. The FCA provides regulatory oversight of financial crime, including anti-money laundering, sanctions, and anti-bribery and corruption. The FCA requires firms to put in place systems and controls to mitigate financial crime risks, and it examines these on an ongoing basis as part of its proactive supervision agenda.

The UK is a member of the Financial Action Task Force (FATF), an international body that sets the standard for anti-money laundering and sanctions. The FATF conducts scheduled mutual evaluation reviews of member countries and these help anticipate future regulatory expectations. The UK will be subject to its next evaluation by 2018.

The European Commission proposed modifications to the Third Anti-Money Laundering Directive (AMLD) which took into account recommendations from the FATF in 2012. The proposals aimed to remove ambiguities in the existing legislation and improve consistency in anti-money laundering and counter-terrorist financing rules across the EU.

The 4th AMLD was adopted by the European Parliament and EU Council of Finance Ministers in May 2015 and will take effect in June 2017. The UK Government is currently consulting on its transposition of this law into national legislation. The business has analysed the revised EU rules and is preparing to implement all required changes once the UK standards have been agreed. UK firms will be required to comply with the updated requirements.

UK firms are required to disclose suspicions of money-laundering to the National Crime Agency. The FCA can take enforcement action against firms that fail to manage their financial crime risks effectively.

#### **General Data Protection Regulation**

The European Commission proposed EU Data Protection Reform in January 2012, in order to adapt data protection rules to the digital environment and harmonise the legislative environment across the EU.

The General Data Protection Regulation (GDPR) was adopted by the European Parliament and the EU Council of Finance Ministers in April 2016 and will apply from May 2018. The business is conducting a gap analysis against the new requirements to identify all required changes, create an implementation plan and is working with its outsourced service providers to make necessary changes.

### **Key insurance functions**

From 1 January 2016, the PRA Rulebook introduced the concept of Key Functions . An operational failure of any of these Key Functions (due to mismanagement or lack of proper oversight) could lead to significant losses being

incurred by the business and a failure of the firm songoing ability to meet its obligations to policyholders. The system of governance of each Solvency II insurance firm and group needs to cover at least the following key functions: risk management, compliance, internal audit and actuarial.

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There is a requirement for every insurance company that carries on long-term business to appoint one or more actuaries to perform the actuarial function in respect of all classes of its long-term insurance business and the with-profits actuary function in respect of all classes of any With-Profits business. Alongside the with-profits actuary, and also forming part of the second line of defence from a compliance perspective, with-profits businesses are required to appoint a with-profits committee. This committee is composed of independent persons and acts in an advisory capacity to inform the decision-making of an insurer s governing body and to ensure that the interests of with-profits policyholders are adequately considered. The with-profits committee advises on the appointment of, and works closely with, the with-profits actuary.

### With-profits business

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

The PRA and FCA share responsibility for the supervision of with-profits business. The PRA views the regulation of with-profits business as an important element of its approach to insurance supervision. The PRA and FCA will continue to liaise on the regulation and supervision of with-profits business according to the framework set out in the with-profits Memorandum of Understanding dated 1 April 2013. The PRA seeks to ensure that any discretionary benefit allocations or other changes with financial implications that the insurer has proposed are compatible with its continued safety and soundness, whereas the FCA has responsibility for monitoring whether the proposed changes are consistent with the insurer s previous communications, the FCA s conduct rules and the overriding obligation to treat customers fairly. The PRA has the power to prevent allocations being made if they would materially impair the firm s safety and soundness.

### **Pensions**

The Pensions Regulator (TPR) is the statutory regulator for all work-based pension schemes in the UK. Its powers are derived from the Pensions Act 2004.

The TPR s statutory objectives are: to protect members benefits; to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF); to promote, and to improve understanding of, the good administration of work-based pension schemes; to maximise employer compliance with automatic enrolment duties and the safeguards introduced by the Pensions Act 2008; and to minimise any adverse impact on the sustainable growth of an employer.

A memorandum of understanding between TPR and FCA sets out the arrangements for cooperation and coordination in carrying out their respective regulatory responsibilities between various Pensions Acts, FSMA 2000 and other relevant legislation.

There is a separate ombudsman, The Pensions Ombudsman, who investigates and decides complaints and disputes over the manner in which pension schemes are run, and works closely with The FOS in cases where their remit overlaps.

#### **Regulation of investment business**

Certain of Prudential s subsidiaries are authorised to carry on investment business and are subject to regulation and supervision under FSMA 2000. UK asset management can also be subject to additional regulation in other jurisdictions in which they operate. For example, certain M&G UK subsidiaries that operate outside of the UK are also subject to regulation by local regulatory authorities.

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### Markets in Financial Instruments Directive (MiFID)

MiFID sets out detailed authorisation and operating conditions for investment firms and regulated markets. In October 2011, the European Commission published proposals to amend MiFID, the MiFID2 Directive and introduce a new Markets in Financial Instruments Regulation (MiFIR). Implementation of the new laws is due to take effect from 3 January 2018, one year after the original deadline. Firms still face a challenging implementation period, with the detailed rules in the process of being finalised.

Once they take effect, the MiFID 2 Directive and MiFIR will have a broad impact on the financial markets in Europe. The new regulations are wide-ranging and they introduce increased pre- and post-trade transparency for fixed income trading, and also a ban on the majority of inducements for independent advisors and discretionary portfolio managers. The introduction of both these new measures is likely to affect M&G investment management business. M&G has begun taking measures to comply with the draft rules, though further changes may need to be made once these rules are finalised.

### Packaged Retail Insurance-Based and Investment Products Regulation ( PRIIPs )

In order to facilitate similar disclosure for all investment products sold to retail clients (including insurance contracts), the European Commission proposed adopting a modified version of the Key Investor Information Document (KIID) for all such products. The KIID will be a two-sided information sheet that will give investors all the key facts and figures about a fund. PRIIPs was agreed by the European Parliament and EU Council of Ministers in March 2014 and was due to take effect from 31 December 2016 but has been delayed by one year to 1 January 2018. The relevant entities in the M&G Group to which PRIIPs will apply are currently reviewing the draft Level 2 rules and have started an implementation project.

### European Market Infrastructure Regulation ( EMIR )

The Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties (CCPs) and trade repositories, widely known as European Market Infrastructure Regulation, (EMIR), came into force on 16 August 2012, with its key provisions taking effect on a phased basis. Full implementation is expected to be achieved by the end of 2020. EMIR s rules are intended to lessen risk and increase transparency within the OTC derivative markets by introducing for most counterparties: (i) a reporting obligation for all derivatives; (ii) a clearing obligation for eligible OTC derivatives; (iii) measures to reduce counterparty credit risk and operational risk for bilaterally traded OTC derivatives, including through collateral requirements; (iv) common rules for CCPs and for trade repositories; and (v) rules on the establishment of interoperability between CCPs. Funds may have to hold more eligible collateral (cash and government bonds) in order to post initial margin.

The relevant EU-domiciled Prudential Group entities have implemented the necessary changes to comply with EMIR requirements currently in effect, including the start of reporting practices and measures to reduce risk for bilaterally traded OTC derivatives. The clearing obligation for certain interest-rate derivatives applied to Prudential Group entities and a few M&G funds from 21 December 2016 and mandatory two-way variation margin has been posted on non-cleared OTC derivatives since 1 March 2017.

### Regimes for the exchange of tax information

Financial institutions in the UK are increasingly being required to provide certain information about their customers, or persons who control their customers, to HMRC. This is due to the introduction and domestic implementation of various international reporting and transparency regimes, including FATCA, the OECD s Common Reporting

Standard (the CRS ) and the EU Directive on administrative cooperation in the field of taxation (the DAC ). The information obtained by HMRC may be exchanged with tax authorities in other countries. The obligations of UK financial institutions to report information to HMRC for the purposes of FATCA, the CRS and the DAC are set out in the International Tax Compliance Regulations 2015 (SI 2015/878) (the International Tax Compliance Regulations ).

For further information about the impact of FATCA, please see US Supervision and Regulation Implementation of US Foreign Account Tax Compliance Act (FATCA) provisions below.

The UK Government has proposed the introduction of two new criminal offences in relation to corporates which fail to prevent the facilitation of tax evasion by their associated persons (which would include employees acting in the

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course of their employment). The first offence would relate to the facilitation of the evasion (by any person) of a UK tax liability and the second would relate to the facilitation of evasion (by a UK company or partnership or where the offender or offence has a UK nexus) of a non-UK tax liability. The proposed legislation is contained in the Criminal Finances Bill 2016 and, subject to the legislative process, is currently expected to become law in early 2017 with these new offences coming into force in the second half of 2017. If the Criminal Finances Bill 2016 is enacted into law in its current form, a corporate entity would not be guilty of an offence provided it could demonstrate that it had in place reasonable procedures to prevent its associated persons from facilitating tax evasion. Prudential is reviewing existing procedures to assess the potential impact of this legislation on the business.

### **Asian Supervision and Regulation**

### 1. Regulation of insurance business

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

The regulatory environment continues to evolve in Asia, where economies in the region are in various phases of maturity. In general (though there are exceptions), regulators in developing economies continue to build the regulatory framework relevant to their level of economic development. This increased regulatory pressure will continue to affect Prudential s Asian businesses as Asian regulators begin to focus more on risk based and risk management approaches.

In general, regulatory regimes will include features governing the registration of agents, regulation of product features, approval of products, asset allocation, minimum capital, the basis for calculating the company s solvency and reserves, the valuation of policyholder liabilities, conditions for outsourcing functions, corporate governance risk management, policyholder and investor protection, as well as anti-money laundering (AML) and sanctions, know your client requirements and data protection requirements. Regulatory authorities may also regulate affiliations with other financial institutions, shareholder structures and the injection of capital and payment of dividends. Financial statements and other returns are filed with the regulators. A number of jurisdictions across Asia require insurance companies to participate in policyholder protection schemes (i.e. contribute to a fund to support policyholders in the event of an insurance company failing).

The increasingly extraterritorial approach of certain regulators outside Asia, aimed among other things at protecting financial systems from systemic risks and curbing tax avoidance, could have wider consequences on financial groups in the Asia-Pacific region. For example, financial institutions are required to comply with new tax information exchange/disclosure regulations or standards with extraterritorial reach such as the US Foreign Account Tax Compliance Act (FATCA) provisions below and the Organisation for Economic Co-operation and Development s Common Reporting Standard (CRS) which aims to increase global tax transparency and improve international tax compliance. Significant changes to business processes and systems are required by Prudential s businesses in Asia in order to comply with the new requirements to identify and report on non-local tax residents. The effects of anti-bribery legislation in the UK, US and elsewhere have also become increasingly significant outside of such legislations home jurisdictions. Prudential Corporation Asia s (PCAs) business units are required to adhere to Prudential s group-wide policy designed to comply with the EU Solvency II requirements. Asian regulators are monitoring closely how Solvency II is developed and implemented but are not currently requiring regulated insurance entities to comply.

Conduct of Business and Consumer Protection continue to be a key priority for regulators in Asia. The focus continues to be on product design, commission structure, marketing literature and sales processes, and agency business models.

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

#### Indonesia PT. Prudential Life Assurance

PT. Prudential Life Assurance is authorised to carry on long-term (i.e. for an indefinite period) insurance business in Indonesia. Prudential s operations in Indonesia are authorised to distribute life insurance products based on either conventional or Shariah principles, through agency and bancassurance (including direct marketing) channels.

The Otoritas Jasa Keuangan (OJK) is the regulator responsible for supervising the banking industry, capital markets and insurance industry. Established as an independent regulator in 2013, the OJK has assumed supervisory responsibility of the non-bank financial institutions from the Ministry of Finance (MoF) and the banking sector from Bank Indonesia (BI). The financial regulatory regime in Indonesia now operates on a twin peaks model with the OJK responsible for microprudential supervision and BI retaining its macroprudential responsibilities. The implementation of AML controls in the insurance industry is monitored by the Indonesian Financial Transaction Reports and Analysis Center (or Pusat Pelaporan dan Analisis Transaksi Keuangan in Indonesian (the PPATK)).

Pursuant to Law Number 40, year 2014, the Indonesia Government is still discussing the maximum cap on foreign ownership and is expected to issue new regulations in due course. The Indonesia Ministry of Finance is responsible for drafting definitive rules on the maximum cap for foreign ownership. While internal consultations are underway, no specific regulation has been issued to date.

### Singapore Prudential Assurance Company Singapore (Pte.) Limited

Prudential Assurance Company Singapore (Pte.) Limited is registered by the Monetary Authority of Singapore (the MAS ) to design and sell both life and accident and health insurance products pursuant to the Singapore Insurance Act and Financial Advisers Act.

Under the Singapore Insurance Act, the MAS is responsible for insurance regulation and supervision of insurance companies. MAS regulation covers, *inter alia*, product development, pricing and management of insurance products, market conduct standards, investments undertaken, public disclosure requirements, reinsurance management, maximum representatives tier structure, loans and advances and product disclosure. The MAS also has responsibility for supervising compliance with AML provisions, though suspicious transactions must also be notified to the Commercial Affairs Department, an enforcement agency of the Singapore Police Force.

In addition, the Singapore Financial Adviser Act gives the MAS the authority to regulate and supervise all financial advisory activities conducted by insurance companies. MAS regulation covers, among other things, the appointment and training of representatives, disciplinary action, mandatory clients—disclosure, sales and recommendations process on investment products, replacement (switching) of investment products and fair dealings with customers. Mandatory clients—disclosure covers both product information and basic data about the representatives and the firm.

The MAS implemented regulations related to Financial Advisory Industry Review (FAIR) in 2015 with the aim of raising the standards and professionalism of the financial advisory industry and enhancing the market efficiency of the distribution of life insurance and investment products in Singapore. FAIR introduced the balanced scorecard remuneration framework that rewards the provision of quality advice in order to align the interests of representatives with that of customers. A direct channel was also required by each insurance company, through which basic insurance products can be purchased with a nominal administration fee, and a web aggregator to enhance comparability amongst life insurance products.

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

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

### **Hong Kong**

Prudential currently operates two subsidiaries, Prudential Hong Kong Limited ( PHKL ) and Prudential General Insurance Hong Kong Limited ( PGHK ), to manage separately the life and general businesses. Both entities market conduct is regulated by the relevant regulators in Hong Kong.

The Office of the Commissioner of Insurance (the OCI) administers the Insurance Companies Ordinance (the ICO). The OCI is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority (the IA) for administering the ICO. The principal functions of the IA are to ensure that the interests of policyholders or potential policyholders are protected and to promote the general stability of the insurance industry, including by authorising insurers to carry on insurance business in Hong Kong, regulating insurers conduct primarily through the examination of the annual audited financial statements and business returns insurers submit, and development of legislation and guidelines on insurance supervision.

The Insurance Companies (Amendment) Ordinance 2015 was enacted by the Legislative Council on 10 July 2015. The Amendments Ordinance provides for the establishment of an Independent Insurance Authority (IIA) which will take over the duties of the existing OCI and the three Self-regulatory Organisations and exercise new statutory powers to licence and regulate insurance intermediaries. Currently, Hong Kong relies on three self-regulatory regimes for supervising the conduct of insurance intermediaries including licensing of agents and brokers, handling complaints, investigation into misconduct and imposing disciplinary sanctions.

The Chairman and Executive Committee members of these self-regulatory organisations are industry practitioners from member companies e.g. Prudential, AIA, AXA. The policy objectives of the IIA are to modernise the regulatory infrastructure to facilitate the stable development of the insurance industry, provide better protection for policyholders, and align with international practice that insurance regulators should be financially and operationally independent of the Government and the industry.

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

The OCI published a guidance note on Underwriting Long-term Insurance Business (GN16) for traditional life products on 30 July 2015. GN16 aims to promote transparency and fair customer treatment. The key requirements of GN 16 include management supervision, product design, clear information disclosure, suitability assessment, advice to customers, appropriate remuneration structure, ongoing monitoring, and post-sale control. GN16 applied to all new products from 1 April 2016, and existing products from 1 January 2017.

In February 2016, the State Administration of Foreign Exchange in China enforced a limit (that was put in place in 2011) on the use of UnionPay bank cards, Visa and Master Card issued by China domestic banks to purchase insurance products overseas; each transaction is capped at USD 5,000. Since November 2016 UnionPay bank cards are not allowed to be used to pay premiums for insurance products with investment-related contents.

### Malaysia Prudential Assurance Malaysia Berhad

Prudential Assurance Malaysia Berhad has a composite licence to carry out both life and general insurance business in Malaysia.

The Bank Negara Malaysia (BNM) is the central bank of Malaysia and is the regulatory body responsible for supervising and regulating the financial services sector, including the conduct of insurance and Takaful business. BNM places considerable emphasis on fair market conduct by the insurance industry and protection of consumers interests and is also responsible for administering legislation in relation to AML matters. BNM has the power to enforce sanctions on financial institutions.

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

The Financial Services Action 2013 (FSA) is now the principal legislation governing insurance businesses in Malaysia. Under this new statutory framework, insurers are required to restructure their lines of business. The regulations require additional resources to be allocated to address any weaknesses of internal controls within the business. The FSA also places greater accountability on the board of directors and senior management in their management and oversight of an insurer.

BNM has issued the implementing regulation on 15 February 2016 for composite insurers to establish separate entities or divest one of their lines of business by 1 July 2018. Prudential is considering its intended approach to complying with the requirements of the implementing regulation.

BNM issued the Life Insurance and Family Takaful Framework ( LIFE Framework ) in November 2015. The LIFE Framework aims to promote innovation and a more competitive market supported by higher levels of professionalism and transparency in the provision of insurance and Takaful products and services. This will be achieved through specific initiatives introduced under the 3 Pillars of the LIFE Framework.

Under Pillar 1, limits on operational costs will gradually be removed to promote product innovation while preserving policy value.

Under Pillar 2, distribution channels will be widened. Life insurance/family Takaful products will be accessible to consumers through a wide range of delivery channels that are most convenient and appropriate.

Under Pillar 3, market conduct in general will be strengthened to enhance consumer protection. The level of professionalism of intermediaries is proposed to be enhanced so as to ensure consumers are given proper advice. The LIFE Framework is being implemented by BNM in phases between 1 December 2015 to 1 January 2019, to take into account the current state of readiness of the life insurers, family Takaful operators and intermediaries, and the level of consumer awareness and literacy.

Market liberalisation measures were introduced by BNM in April 2009, which increases the limit from 49% to 70% on foreign equity ownership for insurance companies and Takaful operators in Malaysia. A higher foreign equity limit beyond 70% for insurance companies will be considered by BNM on a case-by-case basis for companies who can facilitate consolidation and rationalisation of the Malaysian insurance market.

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

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

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

Takaful in Malaysia is considered to be part of mainstream mercantile law, and is subject to the civil court structure at the federal level. It is not regulated by Shariah law in Shariah courts as the Shariah courts do not deal with commercial transactions. However, the operations of a Takaful Operator ( TO ) must conform to the rules and requirements of Shariah as regulated in the Islamic Financial Services Act 2013 ( IFSA ), which came into effect from 30 June 2013, repealing the earlier Takaful Act 1984. The IFSA now provides a comprehensive legal framework that is fully

consistent with Shariah in all aspects of regulation and supervision, from licensing to the winding-up of an institution. The IFSA is similar to the FSA issued for conventional insurers.

The IFSA recognises the BNM s Shariah Advisory Council (SAC) as the sole authority on Shariah matters. As the reference body and advisor to BNM on Shariah matters, the SAC is also responsible for validating all Takaful products to ensure their compatibility with Shariah principles. A TO is also required to establish a Shariah

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Committee, approved by BNM, to which the SAC will give guidance and advice on operations and business activities. BNM has also issued a specific Shariah Governance Framework that prescribes governance arrangements for Islamic Financial Institutions, including TOs.

The BNM s LIFE Framework referred to in the subsection above also impacts on the family Takaful industry.

### Vietnam Prudential Vietnam Assurance Private Limited

Prudential Vietnam Assurance Private Limited (PVA) is licensed and regulated by the Ministry of Finance of Vietnam (the MoF) as a life insurance company. In September 2015, the MoF approved the PVA is application to commercialise individual pension products. An insurance company is not permitted to operate both life and non-life insurance at the same time, except in the case of a life insurance company that offers personal health and protection care insurance as a supplement to life insurance.

The Insurance Supervision Authority of the MoF specifically undertakes the supervision of insurance companies. The fundamental principles of the operation of insurance companies are set out in the Insurance Business Law.

AML controls in the insurance industry are monitored by the Anti-Money Laundering Department under the Banking Inspection, State Bank of Vietnam.

Commencing in January 2016, all PVA s insurance policies must satisfy provisions of the laws on consumer benefit protection regarding format, contents and other aspects which include a review of Terms & Conditions (Policy Provisions), PruQuote (benefit illustrations to customers), Life Certificates, Application Forms and contract amendment notices. All current insurance policies must be registered with the Vietnam Competition Authority under the Ministry of Industry & Trade, in addition to MoF.

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

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

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

In respect of AML, all life insurance businesses are also regulated by the Anti-Money Laundering Office ( AMLO ), it is the authority responsible for enforcement of the Anti-Money Laundering Act, B.E. 2542 (1999). AMLO is an independent governmental agency and all suspicious transaction reporting is to be made to the AMLO.

In the fourth quarter of 2015, the OIC released the Insurance Development Plan Volume 3 (2016-2020). The vision is to further develop and strengthen the insurance industry as well as to ensure sustainable growth and to better gain trust from the public. This plan has set four important strategies, which will foster the development of the insurance system: (i) increasing the financial stability of the insurance industry, improving the insurance industry standard and marketing behaviour of the insurance system; (ii) improving assurance awareness as well as increasing the insurance accessibility to the public; (iii) creating and supporting a competitive and entrepreneurial environment; and (iv) strengthening the infrastructure of the insurance business.

# India ICICI Prudential Life Insurance Company Limited

ICICI Prudential Life Insurance Company Limited (an associate in which Prudential has a 26 per cent share and the major shareholder is ICICI Bank Limited) is authorised to carry on long-term life insurance business in India.

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Insurance is subject to federal regulation in India. The Insurance Regulatory & Development Authority ( IRDA ) is the regulator for insurance business in India. The IRDA s duties include issuing certificates of registration to insurance companies, protecting the interests of policyholders, and regulating, promoting and ensuring the orderly growth of the insurance industry.

The principal legislation for insurance business is the Insurance Act 1938. Regulations and guidelines on specific matters have also been published to fulfil the purposes of the Insurance Act and to provide rules and norms for conduct of operations. In relation to AML and counter financing of terrorism ( CFT ) requirements, insurers must also adhere to requirements of the Prevention of Money Laundering Act 2002 and specific guidelines issued by the IRDA in this regard. The Financial Intelligence Unit-India ( FIU-IND ) is entrusted with the responsibility of receiving cash/suspicious transaction reports, analysing them and, as appropriate, disseminating valuable financial information to intelligence/enforcement agencies and regulatory authorities.

The Insurance Law was amended in March 2015, under which Foreign Direct Investment (FDI) limits in an insurance entity were increased from 26 per cent to 49 per cent. In October 2015, IRDA issued guidelines on Indian Owned and Controlled, which set out the criteria under which control can be exercised through shareholdings, management rights, shareholders agreements, voting agreements or any other manner as per the applicable laws. These guidelines also require the nomination/appointment of the majority of directors (excluding independent directors) and key management personnel (i.e. Chief Executive Officer/Managing Director/Principal Officer) by Indian promoters or investors. In addition, the guidelines require that control over significant policies of the insurance company should be exercised by the company should that its bylaws comply with the aforementioned nomination/appointment requirement.

#### **South Korea PCA Life Insurance Company Limited**

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

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

On 10 November 2016, the Prudential Group announced that it had reached an agreement to sell 100 per cent of PCA Life Insurance Company Limited, to Mirae Asset Life Insurance Co. Ltd, for KRW170 billion (equivalent to £114 million at 31 December 2016 closing exchange rate). The transaction is subject to regulatory approval.

### China CITIC-Prudential Life Insurance Company Limited

CITIC-Prudential Life Insurance Company Limited (Prudential s joint venture with CITIC in which Prudential has a 50 per cent share) is authorised to conduct life insurance business in China. To date, CITIC-Prudential Life had business across China including the key markets of Guangdong, Beijing, Shanghai, Shenzhen, Hubei, Shandong, Zhejiang, Jiangsu, Tianjin, Guangxi, Fujian, Hebei, Liaoning, Shanxi and Henan.

The body responsible for regulation of the insurance sector is the China Insurance Regulatory Commission ( CIRC ). CIRC reports directly to the State Council. CIRC is authorised to conduct the administration, supervision and

regulation of the Chinese insurance market, and to ensure that the insurance industry operates in a stable manner in compliance with the law. CIRC also has local offices in all 41 provinces and selected direct administrative cities and regions across the country, which set and administer implementation rules and guidelines in the application of the regulations introduced by CIRC.

CIRC has focused specific attention on the area of risk prevention, with five identified lines of defence against risks, namely; internal management and control systems, supervision of solvency adequacy, on-site inspection, fund management regulation and insurance security fund. In response to the global financial crisis, more importance has been attached to the supervision of internal control systems, corporate governance, and market conduct and information disclosure by insurance companies.

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The People s Bank of China (PBOC) is entrusted with responsibility and authority to regulate all anti-money laundering activities in China and has actively been developing rules and guidance, requiring insurance companies to abide by the PRC s main AML law and regulations in connection with capital investment, transfers and set-up of new branches, as well as specifying senior management s responsibilities on AML.

### Philippines Pru Life Insurance Corporation of UK

Pru Life Insurance Corporation of UK is licensed in the Philippines as a life insurance company and is also permitted to offer health, accident and disability insurance.

The Insurance Code of the Philippines, as amended ( Insurance Code ), gives the power to supervise and regulate the operations and business of insurance companies to the Insurance Commission ( IC ). The IC is a government agency under the Department of Finance, and is headed by the Insurance Commissioner. IC regulation and supervision seeks, amongst other things, to ensure that adequate insurance protection is available to the public at a fair and reasonable cost and to ensure the financial stability of the insurance industry so that all legitimate claims of the insured public are met promptly and equitably, and to safeguard the rights and interests of the insured.

### Taiwan PCA Life Assurance Company Limited

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

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

### Cambodia Prudential (Cambodia) Life Assurance Plc

Prudential (Cambodia) received its full operating licence from the Ministry of Economy and Finance (MEF) on 31 December 2012 and started selling life insurance policies in January 2013.

The Insurance and Pension Department of the General Department of Financial Industry, a division of the MEF, is the insurance regulator.

Insurance activities are principally governed under the Insurance Law, which came into effect in 2000 (and was further amended in 2014) and the Sub-Decree on Insurance, which was adopted by the Government in September 2001. The MEF has also published specific guidelines on aspects of insurance operations and corporate governance.

#### Laos Prudential Life Assurance (Lao) Company Limited

Prudential (Laos) was granted a licence to establish a representative office in Laos by the Ministry of Planning and Investment of the Lao People s Democratic Republic in March 2015, and received its Insurance Business Operating Licence on 5 April 2016. It commenced its life insurance operations in the Laos in May 2016.

Insurance supervision comes under the purview of the Ministry of Finance. The insurance regulatory framework is based on the Law on Insurance dated 21 December 2011 and the Ministerial Instruction on Implementing the Law on Insurance dated 19 February 2014.

### 2. Regulation of investment and funds businesses and other regulated operations

Prudential conducts investment and fund businesses through subsidiaries or joint ventures ( JV ) in the following countries in Asia through Eastspring Investments: Hong Kong, Japan, Korea, Taiwan, The People s Republic of

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China, India, Singapore, Malaysia, Vietnam and Indonesia. Eastspring Investments also has a presence in Luxembourg, the US and the UK. All operations are authorised and licensed by the relevant authorities. Depending on the licensing regime in the respective countries, Eastspring entities are generally authorised to conduct fund/investment management and investment advisory activities for both retail and institutional funds. In addition, two of the JV companies are licensed to provide Trust services to funds.

The relevant authorities generally have broad supervisory and disciplinary powers, including the power to set minimum capital requirements, to temporarily or permanently revoke the authorisation to carry on regulated business, to suspend registered employees/licensed representatives, and to invoke censures and fines for both the regulated business and its registered employees/licensed representatives. Although the detailed regulations vary, common features of the regulatory regimes in each jurisdiction tend to include investment restrictions, advertising codes, requirements on treating customers fairly, disclosure requirements in prospectuses and/or marketing materials, requirements to seek unit holders—approvals in certain instances, provision of financial statements and other periodic disclosures to regulators and audits by regulators.

While the regulatory environment in Asia is in different phases of maturity for each country, there appears to be a trend of similarly themed regulations across the jurisdictions. These include increased corporate governance, disclosures, oversight on outsourcing and Anti-Money Laundering scrutiny. The key features are highlighted below.

#### Indonesia

PT Eastspring Investments Indonesia is regulated and supervised by the OJK.

#### **Singapore**

Eastspring Investments (Singapore) Limited ( Eastspring Singapore ), an indirect wholly-owned subsidiary of Prudential plc, is regulated by the MAS.

Eastspring Singapore is the appointed fund manager and global distributor of the Luxembourg SICAV funds. As such UCITS and MiFID II are both relevant.

#### **Hong Kong**

Products and services offered by Prudential in Hong Kong are regulated under separate statutory regimes by different regulatory bodies, including the Hong Kong Securities and Futures Commission ( HKSFC ), the Hong Kong Monetary Authority and the Mandatory Provident Fund Schemes Authority ( MPFA ).

Eastspring Investments (Hong Kong) Limited ( Eastspring HK ) is licensed with the HKSFC and authorised to deal in and advise on securities and undertake asset management activities in Hong Kong. It also holds a QFII (Qualified Foreign Institutional Investors) license issued by the China Securities Regulatory Commission ( CSRC ). The company is also registered with the Korea Financial Supervisory Service (KFFS) as an offshore investment advisor for investment advisory business and investment discretionary management business. The funds authorised for offering in Hong Kong by Eastspring HK are also registered in Macau with the Monetary Authority of Macau.

### Malaysia

Eastspring Investments Berhad holds a licence for dealing in securities and fund management. Eastspring Al-Wara Investments Berhad holds a licence for fund management. Both companies are regulated by the Securities

Commission Malaysia.

### Vietnam

Eastspring Investments Vietnam is regulated by the State Securities Commission of Vietnam.

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#### India

ICICI Prudential Asset Management Company Limited is approved by the Securities and Exchange Board of India to act as an Investment Manager of ICICI Prudential Mutual Fund.

#### **South Korea**

Prudential conducts a fund business in South Korea through an indirect, wholly-owned subsidiary, Eastspring Asset Management Korea Co. Ltd. The bodies responsible for the regulation of asset management companies, investment advisers and discretionary management companies are the FSC and its executive arm, the FSS.

#### China

CITIC-Prudential Fund Management Company Limited is regulated by the China Securities Regulatory Commission and holds a licence for mutual funds, DAM products, QDII products and advisory services.

The legislative framework of China s fund industry comprises the China Securities Investment Funds Law and a set of ancillary regulations.

### **US Supervision and Regulation**

#### Overview

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

Insurance regulatory authorities in all the jurisdictions in which Jackson does business require it to file detailed quarterly and annual financial statements, and these authorities have the right to examine Jackson s operations and accounts. In addition, Jackson is generally subject to US federal and state laws and regulations that affect the conduct of its business, as well as similar laws and regulations in Canada and the Cayman Islands. New York and Michigan require their state insurance authorities to conduct an examination of an insurer under their jurisdiction at least once every five years. Both Michigan and New York recently conducted examinations for the three years ended 31 December 2014. The examinations were completed in 2016 and resulted in no material findings or issues.

Jackson has historic small books of business in places such as the Cayman Islands, Puerto Rico, Guam and Argentina and the business is being managed in run-off. In addition, Jackson acquired some policies in Canada as a result of its acquisition of Reassure America Life Insurance Company (REALIC) in 2012.

Jackson s ability to pay shareholder dividends is limited under Michigan insurance law. The Director of the Michigan Department of Insurance & Financial Services (the Michigan Director of Insurance) may limit, or not permit, the payment of shareholder dividends if it determines that an insurer s surplus, with regards to policyholders, is not

reasonable in relation to its outstanding liabilities and is not adequate to meet its financial needs, as required by Michigan insurance law. Unless otherwise approved by the Michigan Director of Insurance, dividends may only be paid from earned surplus.

State regulators also require prior notice or regulatory approval of changes in control of an insurer or its holding company and of certain material transactions with affiliates. Under New York and Michigan insurance laws and regulations, no person, corporation or other entity may acquire control of an insurance company or a controlling interest in any parent company of an insurance company unless that person, corporation or entity has obtained the prior approval of the regulator.

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### Guaranty associations and similar arrangements

Each of the 50 states of the United States, the District of Columbia and the Commonwealth of Puerto Rico have laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. Guarantee funds in both the UK and the US provide for payments to be made to policyholders on behalf of insolvent life insurance companies and are financed by payments assessed on solvent insurance companies based on location, volume and types of business.

### The National Association of Insurance Commissioners ratios

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners (NAIC), in connection with the Insurance Regulatory Information System, annually calculates 12 financial ratios to assist state regulators in monitoring the financial condition of insurance companies. A usual range of results for each ratio is used as a benchmark and departure from the usual range on four or more of the ratios can lead to inquiries from individual state insurance departments. The usual range of results is established by the NAIC for each ratio from studies of the ratios for companies that have become insolvent or have experienced financial difficulties in recent years. As at 31 December 2016, none of Jackson s ratios fell outside the usual range.

### Policy and contract reserve sufficiency analysis

State insurance laws require life insurance companies to conduct an annual analysis of the sufficiency of its life and annuity reserves. A qualified actuary must submit an opinion that states that the reserves, when considered in the light of the assets that an insurance company holds with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurance company. If a qualified actuary cannot provide such an opinion, then the insurance company must set up additional reserves by moving funds from surplus. The 2016 opinion has been submitted to the Michigan Department of Insurance & Finance Services without any qualifications.

### Jackson s capital and surplus

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

As a licensed insurer in the District of Columbia and every state but New York, where it operates through a subsidiary, Jackson is subject to the supervision of the regulators of each jurisdiction. In connection with the continual licensing of Jackson, regulators have discretionary authority to limit or prohibit the new issuance of business to policyholders when, in their judgment, the regulators determine that such insurer is not maintaining minimum surplus or capital or if the further transaction of business will be hazardous to policyholders.

As a Michigan domiciled insurer, Jackson is subject to a prescribed accounting practice which under certain circumstances, allows an insurer to include the value of business acquired as an admitted asset in excess of the amount allowed under NAIC guidance. At 31 December 2016, as a result of the acquisition of REALIC, Jackson admitted US\$278.4 million of value of business acquired in excess of the amount allowed under NAIC guidance.

Jackson has received approval from the Michigan Department of Insurance & Financial Services regarding the use of a permitted accounting practice. This permitted practice allows Jackson to carry certain interest rate swaps at book

value as if statutory hedge accounting were in place, instead of at fair value as would have been otherwise required. The permitted practice expires 1 October 2017, unless extended by the Michigan Director of Insurance. The effects of this permitted practice may not be considered by the company when determining the surplus available for dividends, nor the nature of dividends as ordinary or extraordinary. As at 31 December 2016 and 2015, the effect of the permitted practice decreased statutory surplus by US\$413.0 million and US\$355.5 million, net of tax, respectively. The permitted practice had no impact on statutory net income.

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### Risk-based capital

The NAIC has developed risk-based capital standards for life insurance companies as well as a model act for state legislatures to enact. The model act requires that life insurance companies report on a risk-based capital formula standard that they calculate by applying factors to various asset, premium and reserve items and separate model based calculations of risk associated primarily with variable annuity products. The risk-based capital formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk, market risk and business risk. The NAIC designed the formula as an early warning tool to identify potentially inadequately capitalised companies for the purposes of initiating regulatory action.

Any state adopting the model act gives the state insurance commissioner explicit regulatory authority to require various actions by, or take various actions against, insurance companies whose adjusted capital does not meet minimum risk-based capital standards. The Michigan Department of Insurance & Financial Services takes into account the NAICs risk-based capital standards to determine compliance with Michigan insurance law.

At 31 December 2016 Jackson s total adjusted capital under the NAIC s definition substantially exceeded Michigan standards.

The NAIC is currently conducting an industry consultation with the aim of reducing the complexity in the variable annuity statutory balance sheet and risk management. Following an industry quantitative impact study, changes have been proposed to the current framework; however, these are considered to be at an early stage of development. Jackson continues to be engaged in the consultation and testing process. The proposal is currently planned to be effective from 2018.

### **Regulation of investments**

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

### Implementation of US Foreign Account Tax Compliance Act ( FATCA ) provisions

US federal tax legislation and rules, including those relating to the insurance industry or insurance products, can have a significant impact on Prudential s business. Tax legislation and rules, and their interpretation may change, possibly with retrospective effect, and proposals that would affect such changes are debated periodically by the US Congress.

FATCA was introduced in the US as part of the Hiring Incentives to Restore Employment (Hire) Act on 18 March 2010. FATCA requires Foreign Financial Institutions (FFI s) (such as Prudential plc and many of its subsidiaries) to identify US customers and report certain information on accounts held by US persons and US-owned foreign entities, to either their domestic tax authority (where there is an appropriate intergovernmental agreement in place) for onwards transmission to the IRS, or directly to the IRS on an annual basis. Failure to report can lead to a 30 per cent withholding tax on certain US payments made to the FFI. The start date for implementation of the FATCA regime was 1 July 2014 with the first reports required in 2015. However, the 30 per cent withholding will not apply to payments made before 1 January 2019 (and, furthermore, rules for implementing the 30 per cent withholding, including on how withholding would be applied pursuant to an intergovernmental agreement, have not yet been

written).

The majority of countries where Prudential plc has affected subsidiaries have now entered into intergovernmental agreements with the US to simplify compliance for FFIs in those countries and minimise the risk of withholding, while still meeting the reporting obligations to the US. Prudential plc and its affected subsidiaries have established policies and procedures to ensure compliance with FATCA. FATCA reports were made in 2016 in relation to the 2015 year.

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#### **Securities laws**

Jackson, certain of its affiliates and certain policies and contracts that Jackson issues are subject to regulation under the federal securities laws administered by the SEC. The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations and (in the case of broker dealers) to impose capital and related requirements. Jackson may also be subject to similar laws and regulations in the states in which it provides investment advisory services, offers the products described above or conducts other securities-related activities.

Jackson National Asset Management, LLC ( JNAM ) is registered with the SEC as an investment adviser pursuant to the Investment Advisers Act. The investment companies (mutual funds) for which JNAM serves as an investment adviser are subject to SEC registration and regulation pursuant to the Securities Act of 1933, as amended (the Securities Act ), and the Investment Company Act of 1940, as amended (the Investment Company Act ). Certain of the mutual funds advised by JNAM underlie variable products offered by Jackson. In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product is funded under a separate account that is registered with the SEC as a unit investment trust.

JNAM is registered as a commodity pool operator with the National Futures Association (NFA) pursuant to Commodity Futures Trade Commission (CFTC) regulations and is acting as a commodity pool operator with respect to the operation of certain of the mutual funds. JNAM and the mutual funds have incurred additional regulatory compliance and reporting expenses as a result, which could reduce investment returns or harm the mutual fund s ability to implement its investment strategy.

Curian Capital, LLC ( Curian Capital ) was an affiliate of Jackson that offered personalised investment advice through its separately managed account program to a range of clients. Curian Clearing, LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, registered as a broker-dealer in all applicable states, and has served exclusively as the clearing broker-dealer for the Curian Capital separately managed account program. In addition, Curian Clearing, LLC is a member firm of the Financial Industry Regulatory Authority (the FINRA ), a self-regulatory organisation, and is subject to FINRA s oversight and regulatory requirements.

The Curian Capital separately managed account program terminated on 19 February 2016 and Curian Capital de-registered as an SEC regulated Investment Adviser on 19 October 2016.

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

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

Prudential also conducts certain of its US institutional investment management activities through PPM America, Inc., which is registered with the SEC as an investment adviser under the Investment Advisers Act. PPM America serves as the investment adviser to Jackson and as the primary US institutional investment adviser for certain Prudential subsidiaries, including The Prudential Assurance Company Limited, among others. PPM America also acts as investment sub-adviser to certain US and foreign advisers affiliated with Prudential primarily for US portfolios of accounts or products sponsored or managed by such affiliates, such as US mutual funds, a UK-based pooled investment vehicle, Japanese investment trusts, funds organised under Luxembourg-based SICAVs, a

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South Korean investment trust fund, and Taiwanese investment trust funds for which PPM America serves as investment consultant and dealing services agent. PPM America also serves as an investment adviser to other affiliated and unaffiliated institutional clients including private investment funds. The US mutual funds for which PPM America serves as sub-adviser are subject to regulation under the Securities Act and the Investment Company Act, and other similar vehicles organised outside of the US are also subject to regulation under applicable local law.

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

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

# Disclosure obligations under the US Securities Exchange Act and in particular under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012

Under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, which added Section 13(r) of the Securities Exchange Act of 1934, Prudential is required to disclose certain of its activities and those of its affiliates related to Iran and to persons sanctioned by the US under programs relating to terrorism and proliferation of weapons of mass destruction that occurred in the twelve-month period covered by this report.

Two of Prudential s non-US affiliates have engaged in transactions with persons sanctioned by the US under Executive Order 13224, relating to terrorism. These transactions were entered into in compliance with laws and regulations applicable to the relevant affiliates. The first individual took out a one-off takaful certificate (a Shariah compliant life policy) with Prudential s Malaysian insurance subsidiary in October 2011. It was discovered in March 2012 through automated checking that his name matched various sanctions lists. The policy was for RM600 per month and RM 7,200 was paid for the year in 2016 (equivalent to around US\$135 and US\$1,623, respectively). The matter was reported to the Malaysian government AML and sanctions regulatory authority, the Bank Negara Malaysia Financial Intelligence Unit, in March 2012. Currently, the said policy has been frozen with no top-up, withdrawal or claims permitted, although regular premium payment is still allowed in Malaysian Ringgit. The policy is in force, with no claims submitted or any outward payments made to date.

The second individual is a beneficiary of three life insurance policies in his wife s name, the first taken out in December 2010 and two others taken out in November 2011 with Prudential s Indonesian insurance subsidiary. The annual premium of the three life insurance policies is IDR 6,000,000 (approximately US\$449), IDR 12,000,000 (US\$898) and IDR 12,000,000 (US\$898), respectively. The matter was notified to the Indonesian governmental sanctions authority, the PPATK, in August 2012. All three policies remain in force and annual premiums are being funded by the policies cash value. As such, there have been no premiums received and there have also been no claims or other outward payments in 2016.

As the provisioning of insurance liabilities is undertaken on a portfolio basis, it is not practical to estimate the 2016 net profits on the contracts referred to above. Prudential does not intend to engage in further new business dealings with these individuals.

In the UK, The Prudential Assurance Company Limited operates a pension scheme for employees of the UK branch of government-owned Iranian bank. A total of 67 scheme members are receiving benefits, with 34 deferred members. All members are inactive in that no member contributions are being made.

The scheme is closed to new members. Due to the long term nature of a pension scheme it is not practical to advise the net profit, but the fund value at 31 December 2016 stood at £7,510,071. In return for administering the scheme there are standard Prudential scheme charges: an annual fee of £737, plus £11 per member, £60 per quote and a Trustee Accounts charge (£1910).

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The annual invoice paid on 12 October 2016 was for £3,849 (£737 scheme fee and £1910 Trustee Accounts). In addition to this an Annual Management Charge of 1.25 per cent is reflected in the fund value.

The UK governmental sanctions authority, HM Treasury, has been informed of this arrangement and in 2008 advised Prudential that following an analysis of the deeds, the fund is not owned, held or controlled by the Iranian bank. Payments out of the fund have been approved by HM Treasury through a license. The trustees of the scheme have indicated that they may want to wind up the scheme, in which case, the existing members of the scheme may be provided with their own personal pension plans with us and we would deal with them as individual customers.

## Employee benefit plan compliance

Jackson issues certain types of general account stable value products, such as Guaranteed Investment Contract (GICs) and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. Many of these plans are retirement plans that are subject to the fiduciary standards of ERISA and that are tax-qualified under the Internal Revenue Code. As such, Jackson may be subject to certain restrictions imposed by ERISA and taxes imposed by the Internal Revenue Code. The DOL and the IRS have interpretive and enforcement authority over the applicable provisions of ERISA and the Internal Revenue Code.

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

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

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

The DOL released a final version of its fiduciary rule in April 2016, with initial application from April 2017 and full implementation from January 2018. The Rules would, as currently written, subject many advisers who work with qualified retirement plans and Individual Retirement Accounts to the fiduciary requirements of ERISA, including obligations to avoid conflicts of interest. Those conflict of interest rules are incompatible with many compensation structures that have historically been permissible. However, with the change in the US administration and the release of various Executive Orders, the final form of the Rules remains unclear.

Jackson and NPH have established projects to implement changes necessary to meet the requirements, including potential reliance on a DOL exemption promulgated in connection with the rule, commonly referred to as the Best Interest Contract Exemption (BICE). Jackson has made and continues to consider changes to its product offerings and is working with its distributors to support implementation of BICE or product changes as appropriate.

## Financial services regulatory and legislative issues

The Dodd-Frank Wall Street Reform and Consumer Protection Act ( Dodd-Frank Act ), which represents a comprehensive overhaul of the financial services industry within the US, was enacted in July 2010. The full impact of the Dodd-Frank Act on Prudential s businesses remains unclear, however, as many of its provisions primarily affect the banking industry, have a delayed effective date and/or require rulemaking or other actions by various US regulators over the coming years.

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The Dodd-Frank Act also established the Federal Insurance Office (FIO). The FIO has no direct regulatory authority over US insurers, but it does have certain authority to represent the US government on prudential aspects of international insurance matters, including at the IAIS. The FIO is also authorised to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry.

The Dodd-Frank Act vests the Financial Stability Oversight Council (the Council ) with the power to designate domestic systemically important non-bank institutions which will be subject to special regulatory supervision and other provisions intended to prevent or mitigate the impact of future disruptions in the US financial system. If Jackson is designated in the US as a systemically important non-bank institution, it may be subject to heightened prudential standards to be administered by the US Federal Reserve Board, including heightened capital, leverage and liquidity standards, risk management requirements, single counterparty credit concentration limits, resolution plans and stress tests, and potential discretionary requirements relating to contingent capital, enhanced public disclosure and short term debt limits. As discussed under the Global Regulatory Developments and trends section, Prudential Group was designated as a G-SII in July 2013, which is separate from a Dodd-Frank designation.

Dodd-Frank Act rules and guidance outlining the manner in which the Council will determine which companies should be so designated in the US were adopted in April 2012. The rules set forth a three-stage process of increasingly in-depth evaluation and analysis, drawing on both qualitative and quantitative information (but preserving significant Council discretion). The rules do not, however, permit a definitive view as to whether Jackson would or would not be designated as systemically important in the US context.

In addition, Title VII of the Dodd-Frank Act created a new regulatory regime for certain derivatives called swaps and security-based swaps. Prudential and Jackson have determined that they are not required to register as swap dealers, security-based swap dealers, major swap participants, or major security-based swap participants under Title VII of the Dodd-Frank Act. However, CFTC regulations requiring that swaps be reported to trade repositories and, in some cases, cleared through registered central counterparties and traded on registered exchanges, may apply to certain derivatives entered into by Jackson and, in some circumstances, Prudential. Similar rules for security-based swaps have been proposed, and in some cases finalised, but not yet implemented.

Under Title VII of the Dodd-Frank Act, certain derivatives instruments, including standardised interest rate swaps and index credit default swaps, are required to be cleared and traded on an exchange. While the transition to exchange-traded derivative instruments may limit counterparty risk, it could increase costs associated with such investments, including transaction and exchange fees. The standardisation of exchange-traded derivative instruments may also limit the ability of Jackson and the mutual funds to customise certain derivative instruments with their counterparties. Exchange-traded derivative instruments may also require Jackson and the mutual funds to post additional collateral or limit the types of collateral that may be used for such transactions. Additionally, requirements to post initial and variation margin for uncleared swaps came into effect in September 2016 for certain market participants, primarily swap dealers and major swap participants with very large positions. Variation margin requirements for remaining relevant market participants, including Jackson and the mutual funds, were effective 1 March 2017, while initial margin requirements for these market participants will be phased in through September 2020, based on the notional amount of the participant s uncleared swaps. These developments may limit the ability of Jackson and the mutual funds that its subsidiaries advise to effectively deploy assets in a timely manner.

The timing and the ultimate impact on the management and operations of Prudential and the regulations promulgated, or to be promulgated, pursuant to these statutory provisions, cannot yet be definitively determined.

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

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

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Federal and state regulators have focused on the mutual fund and variable annuity and insurance product industries including the broker-dealer system. As a result of publicity relating to widespread perceptions of industry abuses, including fraudulent and anti-competitive practices among insurance brokers and mutual funds, there have been numerous regulatory inquiries and proposals for legislative and regulatory actions that could affect the operations and management of market participants. In addition, the SEC has implemented a data analytics review process, and periodically makes data requests from registered entities. It is difficult to predict at this time whether changes resulting from industry investigations and/or new laws and regulations will affect the Group s insurance or investment management businesses, and, if so, to what degree.

#### **Additional Jurisdictions**

The Group has also invested in businesses located in various new markets.

A sales operation was launched in Poland during 2013 under the auspices of Prudential UK with an agency network rolled out in the country during 2014. The business is currently offering two simple life and protection products.

The Myanmar business unit is not yet fully operational as a business, although Prudential was awarded a licence to establish a representative office in Yangon, Myanmar in late 2013.

Prudential completed the purchase of Ghana s Express Life Co. in April 2014, marking the entry of the firm into the African life insurance market. Three more acquisitions have since been made in Africa, in Kenya (2014), Uganda (2015) and Zambia (2016).

These developments and such incremental regulation remain immaterial at present in terms of the overall business of the Group.

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## **Supplementary Information on the Company**

## **Company Address and Agent**

Prudential plc is a public limited company incorporated on 1 November 1978 and registered in England and Wales. Refer to Governance Memorandum and Articles of Association for further information on the constitution of the Company.

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

#### **Significant Subsidiaries**

The table below sets forth Prudential s significant subsidiaries.

	Main activity	Country of incorporation
The Prudential Assurance Company Limited	Insurance	England and Wales
M&G Investment Management Limited*	Asset management	England and Wales
Jackson National Life Insurance Company*	Insurance	US
Prudential Assurance Company Singapore (Pte) Limited*	Insurance	Singapore
PT Prudential Life Assurance*	Insurance	Indonesia
Prudential Hong Kong Limited*	Insurance	Hong Kong

<sup>\*</sup>Owned by a subsidiary undertaking of the Company.

The Company has 100 per cent of the voting rights of the subsidiaries except the Indonesian subsidiary, where the Company has 94.6 per cent of the voting rights attaching to the aggregate of the shares across the types of capital in issue. The percentage of equity owned is the same as the percentage of the voting power held.

Each subsidiary operates mainly in its country of incorporation.

### **Investments**

#### General

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

### **Prudential s Total Investments**

The following table shows Prudential s insurance and non-insurance investments, net of derivative liabilities, at 31 December 2016. In addition, at 31 December 2016 Prudential had £174.8 billion of external funds under management. Assets held to cover linked liabilities relate to unit-linked and variable annuity products. In this table, investments are valued as set out in note A3.1 to the consolidated financial statements.

### At 31 December 2016 £m

						010 00			<b>C</b>
								T	Group
									excluding
								assets to	assets to
								cover	cover
								linked	linked
								liabilities	liabilities
								and	and
	TITZ	TIC	A•-	T-4-1	A4			external	external
T	UK	US	Asia	Total	Asset	041	T-4-1	unit	unit
	nsurance .	insurancein	isurance	Insur <b>Mane</b> aș	gement(")	Other	Total	holders <sup>(b)</sup>	holders
Investment	14,635	6	5	14,646			14,646	(4,218)	10,428
properties Investments	14,033	U	3	14,040	-	-	14,040	(4,210)	10,420
accounted for									
using the equity									
method	409		688	1,097	176		1,273		1,273
Financial	407	-	000	1,097	170	-	1,273	-	1,273
investments:									
Loans	3,572	9,735	1,303	14,610	563		15,173		15,173
Equity securities	54,037	120,747	23,581	198,365	158	29	198,552	(135,802)	62,750
Debt securities	90,796	40,745	36,546	168,087	2,359	12	170,458	(135,802) $(21,674)$	148,784
Other investments	7,376	1,821	47	9,244	153	4	9,401	(238)	9,163
Deposits	10,705	1,021	1,379	12,084	95	6	12,185	(1,412)	10,773
Total financial	10,703	-	1,379	12,004	73	U	12,103	(1,412)	10,773
investments	166,486	173,048	62,856	402,390	3,328	51	405,769	(159,126)	246,672
Total investments	181,530	173,048	63,549	418,133	3,504	51	421,688	(163,344)	258,344
Derivative	101,550	173,034	03,347	410,133	3,304	31	421,000	(103,344)	230,344
liabilities	(1,860)	(64)	(265)	(2,189)	(615)	(448)	(3,252)	65	(3,187)
Total investments,	179,670	172,990	63,284	415,944	2,889	(397)	418,436	(163,279)	
net of derivative	1/9,0/0	1/2,990	U3,204	413,744	4,009	(391)	410,430	(103,279)	255,157
net of defivative									

### liabilities

- (a) Investments held by asset management operations are further split in note C2.4 to the consolidated financial statements.
- (b) Prudential s Group statement of financial position includes the line by line investments of unit-linked and the consolidated unit-trusts and similar funds. In the table above, these amounts have been deducted in deriving the underlying investments in the right-hand column.

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Further analysis is included in the consolidated financial statements, in accordance with IFRS 7 Financial Instruments: Disclosures . The further analysis is included in notes C2 and C3 to Prudential s consolidated financial statements.

## **Prudential s Insurance Investment Strategy and Objectives**

Prudential s insurance investments support a range of businesses operating in many geographic areas. Each of the operations formulates a strategy based on the nature of its underlying liabilities, its level of capital and its local regulatory requirements.

#### **Internal Funds Under Management**

Prudential manages 66 per cent of its group funds principally through its fund management businesses, M&G in the UK, PPM America in the United States and Eastspring Investments in Asia. The remaining 34 per cent of the Group s funds mainly relate to assets held to back unit-linked, unit trust and variable annuity liabilities.

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

### Investments strategy and objectives

### Investments Relating to UK Insurance Business

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

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

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

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

#### **Investments Relating to Prudential s US Insurance Business**

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

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

## **Investments Relating to Asian Insurance Business**

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

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

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which makes complete matching challenging. A large proportion of the Hong Kong liabilities are denominated in US dollars and Prudential holds US fixed interest securities to back these liabilities.

## **Description of Property Corporate Property**

As at 31 December 2016, Prudential s UK headquartered businesses occupied 99 properties in the United Kingdom, Europe, Asia and Africa. These properties are primarily offices with some ancillary storage facilities. Prudential s global headquarters is located in London. Of the remainder, the most significant holdings are offices in London and Reading in England, Stirling in Scotland and Mumbai in India. Of the 99 properties, 89 are held leasehold and the rest (10) are short-term serviced offices. The leasehold properties range in size from 500 to 225,000 sq. ft. Overall, the UK, Europe, Africa and Asia property portfolio occupied by the UK headquartered businesses totals approximately 1.1 million sq. ft.

Prudential s UK headquartered businesses also hold one surplus owned property and approximately 8 surplus leasehold properties in the United Kingdom, mostly situated in London. This surplus accommodation (i.e. not occupied by the Group but including those sublet) totals approximately 169,000 sq. ft. There are also two surplus land holdings in the United Kingdom, totalling 57 acres. A high proportion of the surplus estate has been sublet to third party occupiers generating income for the Group to cover this overhead. As at 31 December 2016 vacancy within the surplus estate stood at 7,000 sq. ft.

In the United States, Prudential owns Jackson National Life s executive and principal administrative office located in Michigan. Prudential owns a total of eight facilities in Lansing, Michigan, which total approximately 861,514 sq. ft. Prudential also leases premises in Michigan, Colorado, Tennessee, California, Illinois, New York, New Jersey, Georgia, Florida, Wisconsin, Massachusetts, Connecticut, New Hampshire, Pennsylvania, Texas, Maryland, Washington D.C. and North Dakota for certain of its operations. Prudential holds 34 operating leases with respect to office space, throughout the United States. The leasehold properties range in size from 150 180,000 sq. ft. In the United States, Prudential owns and leases a total of approximately 1,500,732 sq. ft. of property. In addition to the owned and leased properties, Prudential also owns a total of 446 acres of surplus land, all located in Lansing, Michigan.

Prudential s United States headquartered business also sublets three surplus office properties in Lansing, Michigan, totalling approximately 34,193 sq. ft., located in one of its owned properties.

In Asia, Prudential owns or leases properties principally in Hong Kong, Singapore, Malaysia, Indonesia, Thailand, the Philippines, China (joint venture), Taiwan, Japan, Vietnam, India (associate), Korea, Myanmar, Laos and Cambodia.

Within these countries, Prudential owns 53 property assets (including those owned by its with-profits funds), ranging from office space to land holdings. The breakdown of these owned assets by country is as follows:

Malaysia (excluding the Malaysia Takaful joint venture) has twenty six individually saleable owned assets, including Office and residential space totalling 294,789 sq. ft.

Philippines: two owned assets Office space totalling 4,278 sq. ft.

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

Taiwan: sixteen owned assets All surplus land holdings totalling 30,137 sq. ft.

Thailand: eight owned assets Office space and surplus land holdings totalling 36,481 sq. ft.

Prudential has (excluding those owned by its joint venture/associate businesses in China, India and Malaysia (Takaful) a total of 351 external operating leases, totalling approximately 3.58 million square feet of property.

The total holdings for Prudential joint venture/associate businesses in China, India and Malaysia (Takaful) comprises approximately 890 leased properties, totalling approximately 2.40 million square feet. There are six owned assets in Malaysia totalling 12,315 sq. ft. and one owned and occupied asset comprising approximately 40,000 sq. ft. in Mumbai, India.

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

M&G has agreed a pre-let transaction with a developer to lease 323,000 sq ft of offices in Central London, commencing in 2018. The building is currently under construction. The Malaysian headquartered businesses (forming part of Prudential Corporation Asia) have agreed a pre-let transaction with a developer to lease 326,500 sq ft of offices in Kuala Lumpur, commencing in 2019. The building is currently under construction.

There have been no other property transactions subsequent to 31 December 2016 which would have a material impact on the financial position of Prudential.

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

In summary, Prudential owns 42 properties which it also occupies and which are accounted for as owner occupied. These properties are comprised of thirty four in Asia and eight in the US. The India associate also owns and occupies one property in India. The total value of Prudential s owner occupied properties at 31 December 2016 was £351 million. This represents less than 1 per cent of Prudential s total assets.

Prudential is the lessee under 703 operating leases used as office accommodation, comprising 580 leases held by the Asia business, 34 leases held by the US business and 89 leases held by the UK businesses. For the UK based businesses, Prudential holds 10 short-term serviced offices.

### **Investment Interests**

Prudential also holds interests in properties within its investment portfolios accounted for as investment property. At 31 December 2016 the total value of investment properties was £14,646 million and comprised 463 properties held by the UK, 4 held in Asia and 2 held by the US. In total they comprised 3.5 per cent of Prudential s total assets. The UK business holdings account for over 99 per cent by value of the total investment properties.

## **Intellectual Property**

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

Prudential does not operate in the United States under the Prudential name and there have been long-standing arrangements between it and Prudential Financial, Inc. and its subsidiary, the Prudential Insurance Company of America, relating to their respective uses of the Prudential name. Under these arrangements Prudential Financial Inc has the right to use the Prudential name in the Americas and certain parts of the Caribbean, Japan, Korea and Taiwan, and Prudential has the right to use the name everywhere else in the world although third parties have rights to the name in certain countries.

### **Legal Proceedings**

In addition to the matters set out in note C11 to the Consolidated Financial Statements in relation to the Financial Conduct Authority review of past annuity sales, the Group is involved in a number of 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.

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#### Governance

This report describes how Prudential has complied with the governance codes applicable to the Group.

Good governance ensures decisions are made in the interests of the business and take into account the views of stakeholders, including Prudential s employees and customers. Prudential s strategy aims to achieve just this by ensuring there is a responsive governance framework that supports and challenges executives decision making.

#### **Board operations**

The Chairman has responsibility for ensuring the Board process operates effectively and that Prudential establishes an appropriate ethos and culture at Board level, which set the tone from the top around the Group.

Driving that culture means that, when Directors meet as a Board, the Chairman ensures that there is open debate and constructive and effective challenge of the issues under discussion. The Board tests issues rigorously and has a robust decision-making process. There is strong contribution from all Board members and challenge from Non-executive Directors, and the diversity of experience in the Boardroom comes through in the discussions. This ensures that decisions are balanced and all the risks are considered.

### **Supporting Prudential s strategy**

The Chairman also ensures that governance supports the Group's strategy and the long-term success of Prudential. This year specifically, the Board has overseen major transactions in support of strategy: the initial public offering of Prudential's Indian joint venture, ICICI Prudential Life; commencing the divestment of the Korean life business; the launch of a global risk and portfolio management platform for Prudential's asset management businesses; and growing the African business to include Zambia. Every major transaction, including those in the smaller parts of the business such as Africa, is brought to the Board. In each case, management and the Board worked closely together to ensure the right information was provided and key risks were robustly challenged.

#### Governance

The Board keeps its governance structures under constant review to ensure they suit the needs of the business and stakeholders. This year the Board has increased the remit of the Nomination and Governance Committee to provide oversight of the material subsidiary boards. In 2015 the Board identified Prudential Corporation Asia Limited, The Prudential Assurance Company Limited, Jackson National Life Insurance Company (Jackson) and M&G Group Limited as material subsidiaries of the principal business units. Over the first half of 2016, independent non-executive directors were appointed to their boards, including board chairs and chairs of the subsidiary audit and risk committees. To support the new independent directors, a reporting and governance framework was designed. The focus in 2016 was on embedding this framework. Howard Davies, Ann Godbehere and Paul Manduca have established good communication links with the new material subsidiary chairs and material subsidiary risk and audit committee chairs. Prudential continues to see benefits from the greater alignment of the governance within the subsidiary businesses.

### Looking forward

The Board has also focused further on the quality of Environmental, Social and Governance Reporting in 2016 and Prudential will be publishing its first dedicated ESG report later this year. This report provides important information on the Group s approach to managing the business in a sustainable fashion. It explains the actions to support this approach and the benefits Prudential brings to its customers and other stakeholders. The Board firmly believes this

information, coupled with stakeholder engagement, improves the quality of the decisions they make.

However, the Group needs to remain vigilant not only to Prudential s internal needs but also to external factors that may require decisions from the Board. It remains critical for the Board to have an understanding of and respond to policy debates in all markets in which Prudential operates.

## **Culture of the Group**

While the Board can ensure good decision making at an executive level, it is important that the same approach is taken throughout the organisation. The best way to achieve this is to ensure that there exists a culture where

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managers at every level are accountable, stakeholder views are taken seriously and colleagues feel free to challenge decision making. Prudential firmly believes the Board determines culture and the Board aims to exhibit the behaviour expected from all.

#### Stakeholders

The Chairman also oversees the balance of Board consideration between the interests of shareholders, customers, employees and other key stakeholders. An important part of this is the active shareholder engagement that Prudential participates in every year. Prudential welcomed 186 shareholders to the Annual General Meeting in 2016 as well as holding frequent meetings with institutional investors. The quality of people is a key driver of the business s success. Prudential creates an environment in which people find value and meaning in their work, and create shared value for customers, shareholders and communities. The financial peace of mind that Prudential helps to provide to customers remains the focus of Prudential s purpose as a business.

Prudential believes that good governance is based on the right level of oversight and challenge. The committee reports that follow demonstrate the work done this year to ensure that oversight and challenge are in place, and, more importantly, the tangible and positive impact it has had on the business. The methodology and results of the 2016 Board evaluation are also set out below.

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### **Board of Directors**

The Prudential Board consists of 16 directors as at 24 March 2017.

Set forth below are the names, ages, positions, business experience and principal business activities performed by the current Directors, as well as the dates of their initial appointment to the Prudential Board. This includes those Directors who joined the Board up to the date of filing. Ages are given at 24 March 2017.

#### **Board of Directors**

Paul Manduca, Relevant skills and experience

**Chairman** Paul has held a number of senior leadership roles. Notable appointments include

serving as Chairman of the Association of Investment Companies (1991 to 1993), acting as founding CEO of Threadneedle Asset Management Limited (1994 to 1999), directorships of Eagle Star and Allied Dunbar, holding the offices of

**Appointment:** October 2010 European CEO of Deutsche Asset Management (2002 to 2005), global CEO of **Chairman:** July 2012 European CEO of Deutsche Asset Management (1999 to 2002), Chairman of Bridgewell Group plc

and a director of Henderson Smaller Companies Investment Trust plc. Other previous appointments include the chairmanship of Aon UK Limited and JPM

European Smaller Companies Investment Trust Plc.

**Committees:** 

**Age:** 65

Nomination and Governance

(Chair) From September 2005 until March 2011, Paul was a non-executive director of Wm

Morrison Supermarkets Plc, including as Senior Independent Director, Audit Committee Chairman and Remuneration Committee Chairman. He was also a non-executive director and Audit Committee Chairman of KazMunaiGas

Exploration & Production until the end of September 2012.

Other appointments

Paul is a member of the Securities Institute and Chairman of Henderson Diversified

Income Limited and of the Templeton Emerging Markets Investment Trust (TEMIT). Paul is also Chairman of TheCityUK s Advisory Council.

Michael Wells, Relevant skills and experience

**Group Chief Executive** Mike joined Jackson in 1995 and became Chief Operating Officer and

Vice-Chairman of Jackson in 2003. In 2011, he was appointed President and Chief

Executive Officer of Jackson, and joined the Board of Prudential.

**Appointment:** January 2011

**Group Chief Executive:** June

2015

During his leadership of Jackson, Mike was responsible for the establishment of the broker-dealer network National Planning Holdings and the development of Jackson s market-leading range of variable annuities. He was also part of the Jackson teams that purchased and successfully integrated a savings institute, three broker-dealers and two life companies.

**Age:** 56

Mike began his career at the brokerage house Dean Witter, going on to become a managing director at Smith Barney Shearson.

#### **Executive Directors**

Nicolaos Nicandrou ACA, Relevant skills and experience

**Chief Financial Officer** Nic started his career at PricewaterhouseCoopers. Before joining Prudential, he

worked at Aviva, where he held a number of senior finance roles, including Norwich Union Life Finance Director and Board Member, Aviva Group Financial Control Director, Aviva Group Financial Management and Reporting Director and

**Appointment:** October 2009 CGNU Group Financial Reporting Director.

Age: 51 Other appointments

Nic is the Chairman of the European Insurance CFO Forum.

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## Penelope James ACA, Relevant skills and experience

**Group Chief Risk Officer** Penny qualified as a chartered accountant with Coopers & Lybrand Deloitte (now

part of PwC) and then joined Zurich Financial Services, where she held a number of senior finance positions over 12 years. Before joining Prudential, Penny was Group Chief Financial Officer of Omega Insurance Holdings (formerly listed on the London Stock Exchange). Penny joined Prudential in 2011 as the Director of Group Finance,

a position she held until her appointment to the Board in 2015. During that time, she

was leading on the implementation of Solvency II.

**Age:** 47

## Other appointments

Penny serves as a non-executive director of Admiral Group plc and is a member of Admiral s Audit and Nomination Committees.

#### John Foley,

## Relevant skills and experience

Chief Executive of Prudential UK & Europe

**Appointment:** September 2015

John spent over 20 years at Hill Samuel & Co, where he worked in every division of the bank, culminating in senior roles in risk, capital markets and treasury of the combined TSB and Hill Samuel Bank. He joined Prudential as Deputy Group Treasurer in 2000 and became Managing Director of Prudential Capital and Group Treasurer in 2001. During his career at Prudential, John has held the offices of Chief

Appointment: January 2016 Treasurer in 2001. During his career at Prudential, John has held the offices of Cl Executive of Prudential Capital, Group Chief Risk Officer, Group Investment Director and, since 2015, Chief Executive of Prudential UK & Europe. John first joined the Board of Prudential plc in 2011 and was reappointed in January 2016,

having stepped down during his time as Group Investment Director.

**Age:** 60

## **Anne Richards**, Relevant skills and experience

**Chief Executive, M&G** Anne became an analyst for Alliance Capital in 1992 and then moved into portfolio

management roles at JP Morgan Investment Management and Mercury Asset Management. She joined the Board of Edinburgh Fund Managers plc as Chief Investment Officer and Joint Managing Director in 2002 and continued in this role following Aberdeen Asset Management PLC s acquisition of Edinburgh Fund Managers in 2003. Anne was Chief Investment Officer and Head of the EMEA region for Aberdeen Asset Management PLC, positions she held until February

2016.

**Age:** 52

**Appointment:** June 2016

### Other appointments

Anne is Chair of the Court of Edinburgh University and the CERN & Society Foundation, and a member of the Financial Conduct Authority Practitioner Panel.

Barry Stowe,

Relevant skills and experience

Chairman and Chief Executive Officer of the North American Business Unit Barry joined Prudential in October 2006 and was the Chief Executive of Prudential Corporation Asia until June 2015, leading Prudential s Asian business through a period of major growth and development. Before joining Prudential, Barry was President, Accident & Health Worldwide for AIG Life Companies. He joined AIG in 1995 after having held senior positions at Pan-American Life and Willis in the United States.

**Appointment:** November 2006

Other appointments

**Age:** 59 Barry is a member of the Board of Directors of the International Insurance Society.

Tony Wilkey, Relev

Relevant skills and experience

Chief Executive, Prudential Corporation Asia

Tony joined Prudential in 2006 as Chief Executive of Prudential Corporation Asia s network of life insurance operations in Asia across 12 markets, a position he held until his appointment to the Board. Before joining Prudential, he served as Chief Operating Officer of American International Assurance (AIA), based in Hong Kong, overseeing AIA s life companies in South-east Asia.

**Appointment:** June 2015

**Age: 57** 

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#### **Non-executive Directors**

The Hon. Philip Remnant CBE FCA,

Relevant skills and experience

Senior Independent Director

Philip was a senior adviser at Credit Suisse, a Vice Chairman of Credit Suisse First Boston (CSFB) Europe and Head of the UK Investment Banking Department. He was twice seconded to the role of Director General of the Takeover Panel. Philip also served on the board of Northern Rock plc and as Chairman of the Shareholder Executive.

**Appointment:** January 2013

**Committees:** 

Other appointments

Audit

Philip is a Deputy Chairman of the Takeover Panel, a non-executive director of Nomination and Governance Severn Trent plc and the Senior Independent Director of UK Financial Investments Limited. Philip is also Chairman of City of London Investment Trust plc and

Remuneration

Chairman of M&G Group Limited, a subsidiary of Prudential plc.

**Age:** 62

Sir Howard Davies. Relevant skills and experience

> Sir Howard has a wealth of experience in the financial services industry, across the Civil Service, consultancy, asset management, regulatory and academia. Sir Howard was previously Chairman of the Phoenix Group and an independent director of

Morgan Stanley Inc.

**Appointment:** October 2010

**Committees:** 

Audit

Other appointments

Nomination and Governance

Risk (Chair)

Sir Howard is Chairman of the Royal Bank of Scotland and a Professor at Institut d Études Politiques (Sciences Po). He is Chairman of the International Advisory Board of the China Securities Regulatory Commission and a member of the International Advisory Board of the China Banking Regulatory Commission.

**Age:** 66

**Ann Godbehere FCPA** FCGA.

Relevant skills and experience

Ann began her career in 1976 with Sun Life of Canada. Between 1996 and 2003, she held a number of CFO and CEO posts in different businesses within Swiss Re, including Chief Financial Officer of the Swiss Re Group. Ann also held directorships at Northern Rock, Atrium Underwriting Group Limited and Atrium Underwriters

**Appointment:** August 2007

Limited, as well as Arden Holdings Limited.

#### **Committees:**

Audit (Chair) Other appointments

Nomination and Governance Ann is a non-executive director of British American Tobacco p.l.c., Rio Tinto plc,

Rio Tinto Limited, UBS Group AG and UBS AG.

Risk

**Age:** 61

David Law ACA, Relevant skills and experience

David was the Global Leader of PwC s insurance practice, a Partner in PwC s UK

firm, and worked as the Lead Audit Partner for multi-national insurance companies

**Appointment:** September 2015 until his retirement in 2015. David has also been responsible for PwC s insurance and

investment management assurance practice in London and the firm s Scottish

**Committees:** assurance division.

Audit

Other appointments

**Age:** 56 David is a Director and Chief Executive of L&F Holdings Limited and its

subsidiaries, the professional indemnity captive insurance group that serves the PwC

network and its member firms.

Kaikhushru Nargolwala

FCA,

Relevant skills and experience

Kai spent 19 years at Bank of America and was based in Hong Kong in roles as Group Executive Vice President and Head of the Asia Wholesale Banking Group

during 1990 to 1995. He spent 10 years working for Standard Chartered PLC in

**Appointment:** January 2012 Singapore as Group Executive Director responsible for Asia Governance and Risk during 1998 to 2007. Kai was Chief Executive Officer of the Asia Pacific Region of

Credit Suisse AG during 2008 to 2010. Kai previously served on the Board of

Singapore Telecommunications Limited, Standard Chartered plc, Credit Suisse s

Remuneration Executive Board, the Board of Tate and Lyle plc and Visa International s Asia Pacific

Advisory Board.

Risk

**Committees:** 

**Age:** 66

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### Other appointments

Kai is the Chairman of Clifford Capital Pte. Ltd., a company supported by the Singapore government to facilitate the financing of long-term cross-border projects of Singapore-based companies. He is also a non-executive Director of Credit Suisse Group AG and a non-executive Director of PSA International Pte Ltd. Additionally, Kai is the Chairman of the Governing Board of the Duke-NUS Medical School. He serves on the Board of the Casino Regulatory Authority of Singapore. He is also Chairman of Prudential Corporation Asia Limited, a subsidiary of Prudential plc.

**Anthony Nightingale CMG** SBS JP,

## Relevant skills and experience

Anthony spent his career in Asia, where he joined the Jardine Matheson Group in 1969, holding a number of senior positions before joining the Board of Jardine Matheson Holdings in 1994. He was Managing Director of the Jardine Matheson Group from 2006 to 2012.

**Appointment:** June 2013

# **Committees:**

## Nomination and Governance Other appointments

Remuneration (Chair)

Anthony is a non-executive director of Jardine Matheson Holdings and a number of other Jardine Matheson group companies. Other directorships include Schindler Holding Limited, Vitasoy International Holdings Limited and Shui On Land Limited. Notable appointments include: Hong Kong representative to the APEC Business Advisory Council, Chairman of The Hong Kong-APEC Trade Policy Study Group, member of the Securities and Futures Commission Committee on Real Estate Investment Trusts, member of the UK-ASEAN Business Council Advisory Panel, and non-official member of the Commission on Strategic Development in Hong Kong.

**Age:** 69

## Alice Schroeder.

### Relevant skills and experience

**Appointment:** June 2013

**Committees:** 

Audit

Alice began her career as a qualified accountant at Ernst & Young. She joined the Financial Accounting Standards Board as a manager in 1991, overseeing the issuance of several significant insurance accounting standards. From 1993, she led teams of analysts specialising in property-casualty insurance as a Managing Director at CIBS Oppenheimer, PaineWebber (now UBS) and Morgan Stanley. Alice was also an independent board member of the Cetera Financial Group.

#### Other appointments

**Age:** 60

Alice is a non-executive director of Bank of America Merrill Lynch International. She is also CEO and Chairman of WebTuner Corp.

Lord Turner FRS, Relevant skills and experience

Lord Turner began his career with McKinsey & Co, advising companies across a

range of industries. He has served as Director-General of the Confederation of

**Appointment:** September 2015 British Industry, Vice-Chairman of Merrill Lynch Europe, Chairman of the Pensions

Commission and as a non-executive director of Standard Chartered Bank. Lord

Turner was Chairman of the UK s Financial Services Authority (FSA), a member of

the international Financial Stability Board and a non-executive director of the Bank

of England.

**Committees:** 

Risk

Age: 61 Other appointments

Lord Turner has been a crossbench member of the House of Lords since 2005. Other appointments include OakNorth Bank, Chairman of the Institute for New Economic Thinking, Chair of the Energy Transition Commission, and Visiting Professor at both the London School of Economics and the Cass Business School.

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The Board appointed John Foley as Executive Director and Chief Executive of Prudential UK & Europe in January 2016 and Anne Richards as Executive Director and Chief Executive, M&G in June 2016. Alistair Johnston retired as a Non-executive Director at the conclusion of the 2016 Annual General Meeting and Michael McLintock retired as an Executive Director and Chief Executive, M&G in June 2016. All Directors will stand for election or re-election at the 2017 Annual General Meeting except Ann Godbehere, who will have served for nine years since her election by shareholders in 2008. Proposals for elections and re-elections are supported by the annual review of the performance of each Director, which concluded that all Directors continue to perform effectively.

#### **Other Executive Officers**

The heads of Prudential s business units, Prudential UK & Europe, M&G, Jackson National Life Insurance Company and Prudential Corporation Asia, are also directors of Prudential as set forth above. For information relating to the compensation paid or accrued to all Prudential directors see the section Compensation and Employees .

#### **Board Practices**

### How we operate Board roles and governance

Prudential has dual primary listings in the UK and Hong Kong, and has therefore adopted a governance structure based on the UK Corporate Governance Code and the Hong Kong Corporate Governance Code.

Responsibility for governance lies with the Board. The descriptions below explain Board roles and how duties are fulfilled.

#### Chairman

#### Paul Manduca

Overall responsibility for leadership of the Board and ensuring its effectiveness

Responsible for setting the Board s agenda, ensuring the relevant information right focus and promoting constructive debate

Responsible for making recommendations to the Nomination and Governance Committee for the appointment of Directors, and ensuring appropriate induction and ongoing development of Board members

Leading the Board in determining appropriate corporate governance and business values

Meeting regularly with the Non-executive Directors, without the Executive Directors present

Paul works closely with the Group Chief Executive and the Company Secretary to ensure effective Board governance and operation. This included ensuring that Board meetings have the right focus, that enough time is allocated for the discussion of agenda items, in particular stategic issues, and that Directors receive timely and

Paul plays a leading part in the identification of potential candidates for Board succession, working closely with the Group Chief Executive in the succession planning process for Executive Directors

Paul focuses on promoting a culture of openness and debate among Directors, helping to build and maintain constructive relationships between the Executive and Non-executive Directors. When chairing Board meetings, Paul ensures that all views are heard and that the Non-executive Directors have an opportunity to challenge management constructively

Key contact point for the independent chairs of the Group s material subsidiaries

Representing the Company with external stakeholders and acting as key contact for shareholders and regulators to ensure effective communication on governance and strategy of the Group s material subsidiaries

During the year, Paul met with the Non-executive Directors without the Executive Directors being present, on five occasions

Paul meets regularly with the independent chairs

Externally, Paul has a regular programme of meetings with major shareholders throughout the year

Paul plays a key role in the Group s engagement with regulators

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### **Group Chief Executive**

Responsible for the operational management of the Group, on behalf of the **Board** 

Leading the Executive Directors and other senior executives in the management of all aspects of the Board the day-to-day business of the Group

Responsible for implementation of the Board s decisions

Establishing processes to ensure operations are compliant with regulatory requirements

Mike sets policies, provides day-to-day leadership and makes decisions on matters affecting the operation, performance and strategy of the Group, seeking Board approval for matters reserved to the Board

Mike Wells

**Executive Committee** (GEC), which comprises the Executive Directors and the Group functional heads. The Executive Committee supports Mike board for the Chairman in the operational management of the Group, providing the expertise to fulfil the strategic objectives set by

Mike works closely with the Executive Directors in developing the Operating Plan, for approval by the Board

Mike keeps in close contact with the Chairman and ensures he is briefed on key issues

Mike meets with the Group s key regulators worldwide

Mike chairs the Group **Senior Independent** Director

#### Philip Remnant

Acting as sounding

Leading the Non-executive Directors in conducting the Chairman s annual evaluation

Being available to shareholders to address concerns not resolved through normal channels

Philip kept in close contact with the Chairman throughout the year

Philip held meetings in Q1 2017 with the Non-executive Directors to review the Chairman s performance

Philip holds meetings throughout the year with Non-executive Directors as needed, without management being present

#### **Committee Chairs**

and governance of the

provided a written update Responsible for leadership of Committee business to the Board, followed by a Board s principal Committees verbal update after each

Responsible for setting the agenda for Committee meetings and reporting on the Committees activities to and Howard Davies, the the Board

Committee meeting

Ann Godbehere, the Audit Committee Chair. Risk Committee Chair, commenced quarterly

Responsible for providing constructive and effective challenge

Contributing to the development of proposals on Group strategy, offering input based on individual and collective experience

In 2016, Philip offered meetings to Prudential s key shareholders to provide them with an additional channel of communication

The Non-executive Directors have engaged throughout the year with the Executive Directors and management, at **Board and Committee** meetings, as part of site visits, through training sessions and on an informal basis

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Each Committee Chair Non-executive Directors

Audit and Risk Committeemeetings with chairs of Chairs act as key contact points for the independent chairs of the audit and risk committees of the Group s material subsidiaries

The Committee Chairs worked closely with the Company Secretary and management to ensure Committee governance continued to be effective throughout the year How we operate Board decision making

the audit and risk committees of the material subsidiaries during 2016 and provided agreed goals and updates to the Audit and Risk Committees respectively

Responsible for scrutinising the performance of management in meeting objectives

Serving on principal **Board Committees** 

They contributed to the development of strategic options through one-to-one meetings with the Group Strategy team and participated in the annual Strategy Away Day

All Non-executive Directors serve on at least one of the principal **Board Committees** 

The Board is collectively responsible:

To shareholders for the long-term success of the Company and, in particular, for setting the Group s strategy and risk appetite;

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For providing leadership within a framework of effective controls; and

For monitoring management s performance against strategic goals and ensuring appropriate resources are available to achieve these goals.

When making decisions, the Board has due regard to the balance of interests between shareholders, employees, customers and community.

The Board operates in accordance with relevant corporate governance codes and has established a number of principal committees comprising Non-executive Directors to ensure Board duties are appropriately allocated between members.

The Group has established and regularly reviews a governance framework designed to promote appropriate behaviours across the Group to ensure prudent management and protection of the interests of shareholders, customers and other key stakeholders.

As part of the governance framework, the Board has established a control framework to identify significant risks and apply appropriate measures to manage and mitigate them.

The framework sets out the behaviours expected of the Group s employees and requires all business units to seek delegated authority from the Board to carry out actions exceeding pre-determined limits or which could have a material effect on the Group.

Specific key decisions have been reserved to the Board for decision. These include strategic decisions, determination of interim dividends and recommendation of final dividends to shareholders, approval of major transactions, approval of key financial reporting, approval of the overall risk appetite and capital and liquidity positions, and responsibility for the effectiveness of the system of internal control and risk management.

Authority for the operational management of the Group s businesses in order to implement Board strategy and decisions has been delegated to the Group Chief Executive for execution or further delegation by him. The Group Chief Executive is supported by the Group Executive Committee, which receives reports on performance and implementation of strategy for each business unit and discusses major projects and other activities related to the attainment of strategy. The members of the Group Executive Committee and their roles are set out in the Board of Directors section of the 20-F. To manage the Group s delegated authorities and to monitor material expenditure, the Group Chief Executive has established a Chief Executive s Committee, which meets on a weekly basis. The Chief Executive of each business unit has responsibility for the management of that business unit.

#### **Key areas of focus** how the Board spent its time

The Board met on 10 occasions during the year, which included meetings in Kuala Lumpur, Malaysia and Lansing, USA. At the overseas meetings, additional sessions were held outside of the formal Board meetings, to allow the Board to focus on the regional business operations and to spend time meeting local senior management. The Board also held a separate strategy event over two days during the year.

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The table below gives an overview of how the Board spent its time in 2016 and its key areas of focus.

	Feb	Apr	May	Jun	Jul	Sep	Nov	Dec
Strategy and implementation		-	-			-		
Full review of strategy								
Strategic conclusions finalised								
Operating plan review								
Strategic objectives monitoring								
Major projects								
Review of operational performance								
Report from Committee Chairs								
	1.2.3.4	1.3.4	1.4	3	1.4	2.3.4	1.2.4	1.3.4

## Financial reporting and dividends

Full year Half year Review of financial performance

### **Business unit reviews**

**PCA** 

Jackson

M&G

UK&E

**PPMG** 

Africa

## Regulation

ORSA, Solvency II, IMAP CRO report Regulatory and compliance update

5

### Governance and stakeholders

Board evaluation tracking
Succession planning
Corporate responsibility report
Diversity and inclusion
Talent review
Feedback from Chair/NED investor
meetings
Investor conference planning
Notes

<sup>&</sup>lt;sup>1</sup> Audit Committee

- <sup>2</sup> Nomination and Governance Committee
- <sup>3</sup> Remuneration Committee
- <sup>4</sup> Risk Committee
- <sup>5</sup> Including meeting with regulators.

At a number of meetings, the Board considered, and where appropriate approved, major projects. These included Prudential Africa s opening in Zambia, with its acquisition of Professional Life Assurance; the listing of ICICI Prudential Life Insurance Company Limited, Prudential s Indian joint venture with ICICI Bank; commencement of the sale of Prudential s life business in Korea and the implementation of a global risk and portfolio management platform for the Group s asset management businesses, working with BlackRock.

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In addition to the eight full meetings outlined above, two further meetings were held to approve the final full and half year financial reports.

Individual Directors attendance at meetings throughout the year is set out in the table below.

Board and Committee meeting attendance during 2016									
			Nomination and	<b>.</b>	D. 1				
		Audit	Governance	Remuneration	Risk	General			
	Board	Committee	Committee	Committee	Committee	Meeting			
Number of meetings	20010	00		002222	00	1.10001118			
held	10	10*	4	6	8*	1			
Chairman									
Paul Manduca	10	-	4	-	-	1			
<b>Executive Directors</b>									
Mike Wells	10	-	-	-	-	1			
Nic Nicandrou	10	-	-	-	-	1			
Penny James	10	-	-	-	-	1			
John Foley	10	-	-	-	-	1			
Michael McLintock <sup>1</sup>	4/4	-	-	-	-	1			
Anne Richards <sup>2</sup>	6/6	-	-	-	-	-			
Barry Stowe	10	-	-	-	-	1			
Tony Wilkey	10	-	-	-	-	1			
<b>3.</b> 7									
Non-executive									
Directors	10	10	4			1			
Philip Remnant	10	10	4	6	-	1			
Howard Davies	10	10	4	-	8	1			
Ann Godbehere	10	10	4	-	8	1			
Alistair Johnston <sup>3</sup>	4/4	6/6	-	-	-	1			
David Law	10	9/10	-	-	-	1			
Kai Nargolwala	10	-	-	6	8	1			
Anthony Nightingale	10	-	4	6	-	I			
Alice Schroeder	10	10	-	-	-	I			
Lord Turner	9/10	-	-	-	7/8	1			

<sup>\*</sup>The Audit and Risk Committees held a joint meeting in addition to those listed, which was attended by all members from both Committees.

#### **Notes**

- <sup>1</sup> Michael McLintock retired as a Director on 6 June 2016.
- <sup>2</sup> Anne Richards was appointed as a Director on 7 June 2016.
- <sup>3</sup> Alistair Johnston retired as a Director from the conclusion of the Annual General Meeting held on 19 May 2016.

Board and Committee papers are usually provided one week in advance of a meeting. Where a Director is unable to attend a meeting, his or her views are canvassed in advance by the Chairman of that meeting where possible.

### How we operate Board effectiveness

## Actions during 2016 arising from the 2015 review

During the year, the action points identified in respect of the 2015 evaluation were addressed and the Board received an update on progress against those actions in September 2016 and February 2017. The key themes of the 2015 evaluation are set out below.

Governance of subsidiary boards The 2015 Board evaluation recognised that, following the decision to appoint independent non-executive directors to certain of the Group's larger subsidiaries, referred to as the material subsidiaries, more formal oversight of the governance arrangements for the material subsidiary boards would be required. In addition, a process for appointing the material subsidiary independent directors and the relationship between them and the Chairman and Chairs of the Group Audit and Risk Committees would need to be implemented.

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In the first half of 2016, governance processes were established for the Chairman and the Audit and Risk Committee Chairs to meet with their material subsidiary counterparts and keep the Board appropriately updated. In addition, the Audit and Risk Committees receive written updates outlining the business discussed by the material subsidiary audit and risk committees.

The Nomination and Governance Committee played a key part in the establishment and embedding of these governance processes. Regular progress updates were provided to the Board, which tracked alignment to regulatory expectations.

**Post action reviews** The 2015 evaluation noted that the Board should continue to analyse past decisions closely, testing assumptions and projections made in the past.

Reviews of certain past transactions were undertaken by the Risk Committee and the outcome was considered by the Board during its strategy discussions in June.

The Board also discussed a full report of the Group s past actions in Africa which allowed them to confirm the rationale behind the Group s decision to invest in that region and the acquisitions made to date.

**Board papers** On Board processes, the 2015 feedback highlighted the progress made during the year, in particular improvements in clarity of papers. This was another area of focus during 2016, with work undertaken to ensure that the right balance continued to be struck regarding the level of detail provided in papers, especially for technically complex matters. Concise papers assisted the Board in managing a growing agenda.

During the year, updates were issued to senior staff explaining the rationale for Board paper content guidelines, including a reminder of best practices and timelines. The review process for papers is designed to ensure all relevant aspects of Directors duties are addressed and consideration is given to risk, legal, regulatory and other appropriate stakeholder aspects.

**Products and customers** The Board continued holding in-depth focus sessions on products and customers of the Group, primarily through Board visits to the business units. In 2016, these focus sessions took place when the Board visited its overseas operations, as more fully described below.

#### 2016 review and actions for 2017

The performance evaluation of the Board and its principal Committees for 2016 was conducted internally at the end of 2016 and beginning of 2017, through a questionnaire. The findings were presented to the Board in February 2017 and an action plan agreed to address areas of focus identified by the evaluation.

The review confirmed that the Board continued to operate effectively during the year and no major areas requiring improvement were highlighted.

The performance during 2016 of the Non-executive Directors and the Group Chief Executive was evaluated by the Chairman in individual meetings. Philip Remnant, the Senior Independent Director, led the Non-executive Directors in a performance evaluation of the Chairman.

Executive Directors are subject to regular review and the Group Chief Executive individually appraised the performance of each of the Executive Directors as part of the annual Group-wide performance evaluation of all staff.

The following themes were identified as areas for focus in 2017:

**Subsidiary governance** The Board evaluation recognised that the appointment of independent non-executive chairs and directors to the Group's material subsidiaries had been well executed, and a good governance framework established. The Board's focus for 2017 would be on ensuring good subsidiary governance was maintained and best governance practices were shared between the material subsidiaries. Ensuring that reporting by the material subsidiaries to the Board and its Committees continued to be of a high standard would also be emphasised.

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**Board agenda** The Board agreed to continue to ensure time spent at its meetings reflected the Group's strategic and operational priorities. One of the primary ways to achieve constructive debate is to ensure pre-Board preparation is of a very high standard with papers continuing to be delivered on time with succinctly presented facts creating, where needed, a clear decision path. The Board also agreed to build on the work done in 2016 to further increase the Board's focus on products and customers.

**Senior employee focus** The Board evaluation noted the number of successful internal promotions over 2015 and 2016, and that management s focus was now on rebuilding strength in the senior management teams around the Group below GEC level. In 2017, the Board will ensure it remains properly updated in this area and that it continues to have opportunities to meet senior management across all the Group s businesses.

**Remuneration** The Board evaluation noted the growing complexity of remuneration across all UK-listed companies and also the pace of changes in these areas as a result of focus by government and institutional investor groups over recent months. The Board will implement an annual training session for any Non-executive Directors not on the Remuneration Committee to discuss the Directors Remuneration Policy and the remuneration structures contained in it, as well as broader market practice information.

The Board will track its progress in addressing these themes at its meetings throughout the course of 2017 and report on actions taken in its next Annual Report.

# **Directors** development

The Chairman is responsible for ensuring that induction programmes are provided for all new Directors. These are tailored to reflect the experience of each Director and their position as either Executive or Non-executive Directors. Anne Richards induction was carried out by both Group and M&G, and included updates on the Group s results, the role of the Board and its Committees, the Group s key risks and the risk management framework, as well as the compliance environment in which the Group operates. M&G provided a detailed briefing on product range, the markets in which it operates and the overall competitive environment.

The Chairman is also responsible for ensuring that all Directors update their skills, knowledge and familiarity with the Group. Directors regularly receive reports on the Group s businesses and the regulatory and industry-specific environments in which it operates. All Directors have the opportunity to discuss their development needs as part of the annual Board effectiveness review and Directors are asked to provide a record of training received externally on an annual basis.

In 2016, the Board took time for particular focus on the Group s US and Asian businesses. During visits to the US and Malaysia, the Board received updates on key products and distribution, risks and performance in the US and in the Asian businesses, including regulatory developments and their potential impact on future business. The Board s overseas visits also allowed the Directors to meet with the local senior management teams.

# Kuala Lumpur, Malaysia

Prudential Malaysia

Overview of life insurance industry and comparative position in the marketplace

# Lansing, USA

Regulatory update impact of the Department of Labor s fiduciary rule on Jackson and the industry

Jackson:

Products and strategy Comparative position in the marketplace and marketing

Financial performance

Products and operating environment

Update on Takaful business: governance, performance, strategy

Financial performance

Asia financial performance, strategy and growth update, risk profile and risk function development, and HR planning

Risk function development

PPM America performance

Overview of Eastspring Investments

Cyber security within the North American business. The Board was kept updated on key political and regulatory developments, including Solvency II implementation and reporting, the US Department of Labor fiduciary rule, the Senior Insurance Managers Regime, the UK regulator s thematic review of annuity sales and the implementation of the Market Abuse Regulation. In addition, Directors were provided with updates at each Board meeting on other legal and regulatory changes and developments that could impact the industry or the Group.

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Committee members received updates at Committee meetings on areas of particular relevance to the respective Committees and were kept updated on ongoing developments in regulations, as well as the impact these have on the Group. The Risk Committee received in-depth information on a number of business areas and products in 2016, focusing on the particular risks arising and how these are managed. Some of those topics were also shared with the Audit Committee to ensure it was appropriately briefed to assess any impact on financial reporting and internal control. In 2016, the Audit Committee and Risk Committee held a joint session in which they were provided with an update on the impact of Solvency II on the 2015 results.

# **Diversity**

Given the global reach of the Group s operations, and our business strategy and long-term focus, the Board makes every effort to ensure it is able to recruit directors from different backgrounds, with diverse experience, perspective and skills. This diversity not only contributes towards Board effectiveness but is essential for successfully delivering the strategy of an international Group, as reflected in our Group Diversity and Inclusion Policy.

The Board is committed to recruiting the best available talent and appointing the most appropriate candidate for each role, while at the same time aiming for appropriate diversity on the Board. This approach informed the Nomination and Governance Committee songoing activities carried out during 2016 in respect of succession planning for Executive and Non-executive Directors.

The Board does not endorse quotas as these may generate unintended consequences, but continues to commit to developing a robust and diverse talent pipeline and increasing representation of women in senior positions in the Group and on the Board. As part of this commitment, the Board may endorse relevant measurable objectives for increasing diversity. For example, in 2016 the Board decided to sign the HM Treasury Women in Finance Charter, with the aim to have in place at least 30 per cent women in senior management positions by the end of 2021.

# Shareholder engagement

As a major institutional investor, the Board recognises the importance of maintaining an appropriate level of two-way communication with shareholders.

The Company holds an ongoing programme of regular contact with major shareholders, conducted by the Chairman, to discuss their views on the Company s governance. The Senior Independent Director offers meetings to major shareholders as needed and other Non-executive Directors are available to meet with major shareholders on request.

Shareholder feedback from these meetings is communicated to the Board.

In addition, a full programme of engagement with shareholders, potential investors and analysts, in the UK and overseas, is conducted each year by the Group Chief Executive and the Chief Financial Officer, led by the Director of Strategy and Capital Market Relations. As part of this, a conference for investors and analysts has been held on a regular basis since 2010, with in-depth business presentations and opportunities for attendees to meet with members of the Board and senior management through the course of the event. Most recently, the Group held a conference for investors in November 2016. The Group Chief Executive, Chief Financial Officer and investor relations team also attend major financial services conferences to present to and meet with the Company s shareholders. In 2016, as part of the investor relations programme, over 360 meetings were held with approximately 800 individual institutional investors across the UK, in continental Europe, the US and Asia.

The Annual General Meeting is an opportunity for further shareholder engagement, for the Chairman to explain the Company s progress and, along with other members of the Board, to answer any questions. All Directors then in office attended the 2016 Annual General Meeting.

Details of the 2017 Annual General Meeting are available on www.Prudential.co.uk under Investors .

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# **Further information on Directors**

Information on a number of regulations and processes relevant to Directors, and how these are addressed by Prudential, is given below.

#### Area

# Rules governing appointment and removal

# Terms of appointment

# Prudential s approach

The appointment and removal of Directors is governed by the provisions in the Articles of Association (the Articles), the UK Corporate Governance Code (the UK Code), the Hong Kong Corporate Governance Code (HK Code) as appended to the Hong Kong Listing Rules (the HK Listing Rules) and the Companies Act 2006.

Non-executive Directors are appointed for an initial term of three years.

Subject to review by the Nomination and Governance Committee and re-election by shareholders, it would be expected that Non-executive Directors serve a second term of three years.

After six years, Non-executive Directors may be appointed for a further year, up to a maximum of three years in total. Reappointment is subject to rigorous review as well as re-election by shareholders at the Annual General Meeting.

The Directors remuneration report sets out the terms of the Non-executive Directors letters of appointment on page 197.

The Directors remuneration report sets out the terms of Executive Directors service contracts on page 196.

Prudential is one of the UK s largest institutional investors. The Board does not believe that this compromises the independence of those Non-executive Directors who are on the boards of companies in which the Group has a shareholding. The Board also believes that such shareholdings should not preclude the Company from having the most appropriate and highest calibre Non-executive Directors.

The independence of the Non-executive Directors is determined by reference to the UK Code and HK Listing Rules. Prudential is required to affirm annually the independence of all Non-executive Directors under the HK Listing Rules and the independence of its Audit Committee members under Sarbanes-Oxley legislation.

For the purposes of the UK Code, throughout the year, all Non-executive Directors were considered by the Board to be independent in character and judgement and to have met the criteria for independence as set out in the UK Code.

All the Non-executive Directors are considered independent for the purposes of the Company s Hong Kong listing, and each Non-executive Director provides an annual confirmation of his or her independence as required under the HK Listing Rules. The Company has considered David Law s position and has deemed him to be independent from 1 July 2016, being the date one year following his retirement from PwC, for the

# **Independence**

Audit Committee experience and

independence

purposes of the HK Listing Rules and HK Code.

There were no other material factors that were deemed to affect the Non-executive Directors independence.

In relation to the provisions of the UK Corporate Governance Code and HK Listing Rules, the Board is satisfied that Ann Godbehere and David Law have recent and relevant financial experience.

The Board has determined that Ann Godbehere and David Law qualify as audit committee financial experts under the requirements of Form 20-F and that both Ms Godbehere and Mr Law are independent within the meaning of Rule 10A-3 under the Exchange Act.

The Board does not consider that Mr Law s previous position at PwC affects his status as an independent Director for the purposes of the UK Code or in relation to his membership of the Audit Committee, under applicable Sarbanes-Oxley legislation.

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Prudential s approach		
Subject to the provisions of the Companies Act 2006, the Company s Articles permit the Directors and officers of the Company to be indemnified in respect of liabilities incurred as a result of their office.		
Suitable insurance cover is in place in respect of legal action against directors and senior managers of companies within the Group.		
Qualifying third party indemnity provisions are also available for the benefit of the Directors of the Company and certain other such persons, including certain directors of other companies within the Group.		
Qualifying pension scheme indemnity provisions are also in place for the benefit of certain pension trustee directors within the Group.		
These indemnities were in force during 2016 and remain so.		
Directors have the right to seek independent professional advice at the Group s expense At no time during the year did any Director hold a material interest in any contract of significance with the Company or any subsidiary undertaking.		

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# **Governance Committees**

# **Committee reports**

The principal Committees of the Board are the Nomination and Governance, Audit, Risk, and Remuneration Committees. These Committees form a key element of the Group governance framework, facilitating effective independent oversight of the Group s activities by the Non-executive Directors.

Each Committee Chairman provides an update to the Board of each Committee meeting, supported by a short written summary of the Committee business considered.

# **Nomination and Governance Committee report**

This report describes how the Nomination and Governance Committee has fulfilled its duties under its terms of reference during the year.

In 2016, the Committee met on four occasions. Its focus was on ensuring that Prudential has suitable succession plans in place for the Board and senior executives. Particular emphasis this year was on succession planning for Non-executive Directors given that Ann Godbehere is in her ninth year of service and will not stand for re-election at the next Annual General Meeting.

Work on succession planning is based on an assessment of skills needed to fulfil Prudential strategy and a rolling programme of progressively refreshing the skills on the Board. During 2016 and to date, the Committee particularly focused on skills required to replace Ann s expertise in the context of the overall balance of skills on the Board and the main markets in which Prudential operates, now and in the medium term. The Committee also reviewed the membership of the Board s principal committees to ensure all committees continue to be appropriately composed, taking into account the time commitment required of each Non-executive Director role.

As part of the regular year-end related work at the February meeting, the performance and independence of the Non-executive Directors was reviewed. The Committee confirmed that the Audit Committee has the required levels of financial expertise, and also reviewed and confirmed conflicts of interest for all Board members and recommended all Non-executive Directors for re-election at the forthcoming Annual General Meeting, except Ann Godbehere.

The Committee expanded its remit in 2016, following the appointment of independent non-executive directors to the boards of the material subsidiaries. During the year, the Committee approved the appointment of independent chairs to the boards of these companies. As part of the Committee s new governance duties, it reviewed the governance framework for the material subsidiaries and terms of reference for their boards and chairs. Going forward, the Committee will review the performance of the non-executive directors of the material subsidiaries, starting in early 2017.

The Chairman of the Committee has responsibility for ensuring the Committee operates effectively. To ensure it does so and provides constructive challenge to management, open debate and contributions from all Committee members are encouraged by the Chairman of the Committee. An annual review of the Committee s effectiveness was carried out as part of the Board evaluation, described in more detail below. The Committee was found to be functioning effectively.

Committee members	Regular attendees
Paul Manduca (Chairman)	Group Chief Executive
Howard Davies	Group Human Resources Director
Ann Godbehere	Group General Counsel and Company Secretary
Anthony Nightingale	
Philip Remnant	

# Number of meetings in 2016: Four

Feb<sup>1</sup> Sep Nov

# Re-election of Directors, Non-executive Directors performance and independence

**Succession planning** 

Membership review of principal Board Committees

Material subsidiary governance

**Committee terms of reference** 

**Notes** 

How the Committee spent its time during 2016

The table below provides an overview of how the Committee spent its time in 2016.

# Key matters considered during the year

Matter considered	How the Committee addressed the matter
Succession planning	The Committee kept succession plans for executive and non-executive Board roles under continuous review. This review takes account of the size, structure and composition of the Board and its Committees, including the overall knowledge, experience and diversity of the Board. The Committee
Appointments	makes recommendations to the Board based on its review as necessary.
Non-executive Directors	
Executive Directors	During 2016, the Committee considered information about potential candidates who might be appointed to the Board as Non-executive Directors to keep the Board composition progressively refreshed in the future, assisted by Russell Reynolds as search consultant.
	John Foley and Anne Richards were appointed during 2016. The work of the Committee in respect of those appointments, which was supported by Egon Zehnder as search consultant, is described in the Annual Report for 2015.
	The Committee received details of the succession plans in place for Executive Directors and other senior management positions. The development and renewal of these plans was led by the Group HR Director, who was supported by Egon Zehnder in identifying candidates who could be considered successors for key roles.

<sup>&</sup>lt;sup>1</sup> Two meetings were held in February

Russell Reynolds has no additional connection with Prudential. In addition to acting as search consultant for certain executive hires, Egon Zehnder also provides support for senior development assessments.

# **Re-election of Directors**

As part of its ongoing work on Board succession planning, the Committee considered the terms of appointment for the Chairman, Committee Chairmen and Non-executive Directors taking into account time commitment and the general balance of skills, experience and knowledge on the Board, assessing length of service in their roles. Having reviewed the performance of relevant Non-executive Directors in office at the time, the Committee recommended to the Board that those Non-executive Directors should stand for re-election at the 2017 Annual General Meeting.

The Committee considered the term of appointment of Ann Godbehere, who has been a Non-executive Director since 2007 and Chairman of the Audit Committee since 2010. In line with corporate governance guidelines, Ms Godbehere does not intend to stand for re-election in 2017.

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Matter considered	How the Committee addressed the matter
	Philip Remnant completed his first term of three years following his initial appointment by shareholders at the 2013 Annual General Meeting. Following performance evaluation by the Committee and re-election by shareholders in 2016, he was invited to serve a further term of three years, expiring at the conclusion of the 2019 Annual General Meeting.
Independence	The Committee considered the independence of the Non-executive Directors against relevant requirements as outlined on page 150.
<b>Conflicts of interest</b>	The Board has delegated authority to the Committee to consider, and authorise where necessary, any actual or potential conflicts of interest in accordance with relevant legislation, the provisions in the Company s Articles and the procedures approved by the Board.
	In February 2016, the Committee considered the external appointments of all Directors and reviewed existing conflict authorisations, reaffirming or updating any terms or conditions attached to authorisations where required. No other conflict matters were brought to the Committee.
	New external positions were reviewed during the year as they arose.
	The Board considers that the procedure set out above for dealing with conflicts of interests has operated effectively.
Governance - Group subsidiaries	In February, the Committee expanded its remit to include oversight of the material subsidiary governance and independent directors.
	During the year, the Committee approved the appointments of the material subsidiary chairs (including Philip Remnant and Kai Nargolwala), reviewed the material subsidiary governance arrangements, approved the terms of reference for the material subsidiary boards and board chairs, and monitored the embedding of governance processes.

# **Audit Committee report**

Report on the activities of the Audit Committee

This report describes how the Audit Committee has fulfilled its duties under its terms of reference during the year.

The Committee met on 10 occasions during the year. The Committee works closely with the Risk Committee to ensure both Committees are updated on matters which impact on their responsibilities. Where a matter requires input from both Committees, joint meetings are held with the Risk Committee. In 2016, one joint meeting with the Risk Committee took place to discuss the Solvency II capital position as at 31 December 2015 and associated governance processes.

The Committee maintained its focus during the year on monitoring the integrity of financial reporting and ensuring suitable accounting policies were adopted and applied consistently. The Committee reviewed management s annual process for setting assumptions underpinning the Group s European Embedded Value (EEV) results and IFRS insurance liabilities and requested additional analysis and information where required. Clarity of the Group s external disclosures is an important consideration of the Committee and it assessed whether the financial report for 2016 was fair, balanced and understandable before making a recommendation to the Board. Additional consideration was given to the Group s disclosure of alternative performance measures in light of new regulatory guidance and the Committee reviewed and agreed the resulting refinements to the Group s disclosures. The Committee also reviewed the Group s external Solvency II disclosures following the formal introduction of the Solvency II framework for European insurers at the start of 2016.

The Committee approved all non-audit services, as well as audit services, to ensure the auditor remains independent. The Committee continued with its annual process of monitoring auditor effectiveness through a Group-wide questionnaire of senior finance personnel. Committee members meet privately with both the internal and external auditors to ensure they are able to operate effectively and to satisfy themselves that management are responsive to their findings and recommendations.

The Committee continued to monitor second and third line of defence functions to ensure their effectiveness. During 2016, the Audit Committee commissioned an external review to provide an independent assessment of compliance monitoring and internal audit reviews. Recommendations from this work have been approved and integrated into the respective functional plans going forward. The focus of the compliance plan is on strengthening the Compliance framework and further enhancing monitoring arrangements and mitigation of key risks. The internal audit plan provides risk-based coverage of financial, business change, regulatory and operational risk drivers and of customer outcomes.

The Committee also refined the governance processes during the year to enhance the information the Committee receives on the activities of the Group s business unit audit committees and ensure key issues are escalated appropriately. The Chairman of the Committee maintains regular contact with the audit committee chairs of the Group s material subsidiaries and reports to the Committee on the issues discussed.

The Chairman of the Committee has responsibility for ensuring the Committee operates effectively. To ensure it does so and provide constructive challenge to management, open debate and contributions from all Committee members are encouraged by the Chairman of the Committee. An annual review of the Committee s effectiveness was carried out as part of the Board evaluation, described in more detail below. The Committee was found to be functioning effectively.

Committee members	Regular attendees
Ann Godbehere (Chairman)	Chairman of the Board
Howard Davies	Group Chief Executive
Alistair Johnston (until May 2016)	Chief Financial Officer
David Law	Group Chief Risk Officer
Philip Remnant	Director of Group Finance
Alice Schroeder	Group Regulatory and Government Relations Director
	Group General Counsel and Company Secretary
	Director of Group Compliance
	Director of Group-wide Internal Audit
	External Audit Partner

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Number of meetings in 2016: 10 (in addition, a joint meeting was held with the Risk Committee)

# How the Committee spent its time during 2016

The table below provides an overview of how the Committee spent its time in 2016.

Jan Feb Mar<sup>1</sup> Apr May Jul Aug Nov Dec

# Financial reporting and external auditor

Periodic financial reporting including:

key accounting judgements and disclosures,

Solvency II results and governance processes, and associated

audit reports

Developments in tax disclosures

Audit planning, fees, effectiveness, independence and re-appointment

# **Internal control framework effectiveness**

Internal control framework effectiveness

#### **Internal Auditors**

Status updates and effectiveness

Internal audit plan for 2017

# Compliance

Status updates

Compliance plan for 2017

# Financial crime and whistleblowing

Update on whistleblowing issues raised

Anti-money laundering report

Security and resilience development plan

# Governance

Internal framework effectiveness/ refresh

Planning for ESG governance and reporting

Business unit audit committee effectiveness and terms of reference

Committee terms of reference

# Note

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<sup>&</sup>lt;sup>1</sup> Two meetings were held in March

# Key matters considered during the year

# Matter considered Financial reporting and tax

#### How the Committee addressed the matter

One of the Committee s key responsibilities is to monitor the integrity of the financial statements.

#### **Overview**

The Committee assessed whether appropriate accounting policies had been adopted throughout the accounting period and whether management had made appropriate estimates and judgements over the recognition, measurement and presentation of the financial results. There were no new or altered accounting standards in 2016 that had a material effect on the Group's financial statements. The Committee also reviewed the accounting for the planned disposal of the Korea life business, together with the presentation in the financial statements.

**Key assumptions and** 

judgements

The Committee considered compliance with accounting standards and obligations under applicable laws, regulations and governance codes. Particular areas on which the Committee focused during the year included the fair, balanced and understandable requirement under the UK Corporate Governance Code, providing advice to the Board in respect of this requirement. This included consideration of any resulting changes to disclosures following the decision by the UK to leave the European Union in June. The Committee also focused on the guidance issued by the European Securities and Markets Authority on Alternative Performance Measures that was effective for the first time in 2016. The Committee reviewed and agreed the refinements to the Group s disclosures as a result of that new guidance. The Committee reviewed the key assumptions and judgements made in valuing the Group s investments, insurance liabilities and deferred acquisition costs under IFRS, together with reports on the operation of internal controls to derive these amounts. It also reviewed the assumptions underpinning the Group s European Embedded Value (EEV) metrics. The Committee considered information, including peer comparisons if relevant and available, on the following key assumptions:

Persistency, mortality, morbidity and expense assumptions within the Asia life businesses;

Economic and policyholder behaviour assumptions affecting the measurement of Jackson guaranteed liabilities and amortisation of deferred acquisition costs; and

Mortality, expense and credit risk assumptions for the UK annuity business.

2016 saw the formal introduction of the Solvency II framework for European insurers. The Committee reviewed the Group's external disclosures of its Solvency II position, together with the consistency of assumptions with those used for IFRS and EEV reporting where relevant. In addition, given the adoption of Solvency II as the local regulatory requirement for the UK business, it reviewed the impact of the change in local capital regime on the EEV results for the UK insurance operations.

The Committee also received information on the nature of goodwill and intangible asset values and the carrying value of investments in the Group s balance sheet. It considered what factors might give rise to an impairment of the Group s intangibles and whether those factors had arisen in the period. The Committee was satisfied that there was no impairment of the Group s intangibles at 31 December 2016. Following the UK referendum in June, where the majority voted in favour of leaving the

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# **Matter considered**

# **How the Committee addressed the matter**

European Union, and the resulting suspension of trading by some property funds, the Committee reviewed the Group s valuation basis for property investments and property funds at 30 June. The Committee satisfied itself that these and other investments were valued appropriately.

Solvency II results and associated governance processes were considered in a separate meeting held jointly with the Risk Committee.

# Other financial reporting matters and tax reporting

No significant issues arose in respect of these items.

The Committee considered various analyses from management regarding Group and subsidiary capital and liquidity prior to recommending to the Board that it could conclude that the financial statements should continue to be prepared on the going-concern basis and the disclosures on the Group's longer-term viability were both reasonable and appropriate. The Committee reflected on how the viability statement could be enhanced to give more insight on the conclusions reached and updates were made accordingly.

As part of its assessment of the description of performance within the Annual Report, the Committee considered judgemental aspects of the Group's reporting across the Group's IFRS and EEV metrics. This assessment included a review to ensure that the allocation of items between operating and non-operating profit was in accordance with the Group's accounting policy. The Committee considered the impact of equity and interest rate movements on the IFRS results of the Group's US business and after discussion, the Committee was satisfied that the presentation and disclosure of such impacts was appropriate and consistent with prior periods.

The Audit Committee also considered judgemental matters regarding provisions for certain open tax items including tax matters in litigation. The Committee received information on the Group s annual risk rating meeting with HM Revenue & Customs. The Committee reviewed the Group s preparations for new country-by-country reporting disclosure requirements to tax authorities, and the Group s preparations for public disclosure of the Group s tax strategy. The Committee was satisfied that management s approach was reasonable in these areas.

For all the above areas, the Committee received input from management and the external auditor prior to reaching its conclusions.

External audit, review of effectiveness, non-audit services and auditor reappointment

In addition to these reporting matters, the Committee also received and considered regular updates from management on the status and implications for the Group of financial reporting developments, including updates on discussions by the International Accounting Standards Board on the development of the IFRS 17 Insurance Standard (known previously as IFRS 4 Phase II ) and the permitted deferral of IFRS 9 by insurers. The Group s external auditor is KPMG LLP and oversight of the relationship with them is one of the Committee s key responsibilities. The Committee approved KPMG s terms of engagement for the statutory audit, and approved fees for both audit and non-audit services in accordance with the Group s policy.

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# **Matter considered**

# **External audit effectiveness**

# How the Committee addressed the matter

To assess the effectiveness of the auditor, the Committee reviewed the audit approach and strategy, and received an internal report on their performance.

The separate internal evaluation of the auditor was conducted using a questionnaire which was circulated to the Committee, the Chief Financial Officer and the Group s senior financial leadership for completion. In total, 89 people provided input on the performance of the auditor.

The feedback provided was reviewed and compiled into a report for the Committee which covered areas such as the knowledge and expertise of the partners and team members, their understanding of the Group, the resourcing applied to the audit and continuity of the team, liaison with Group-wide Internal Audit and approach to resolution of issues, as well as factors such as their coordination across the Group s multiple jurisdictions and quality of their written and oral communication. The degree of challenge and robustness of approach to the audit were key components of the evaluation.

The Committee Chairman invited other Group stakeholders to provide their views on the performance of the auditor, and KPMG was given the opportunity to respond to the findings in the report.

In addition to the usual auditor effectiveness process, early in 2016 the Committee also considered KPMG s response to a report issued by the Financial Reporting Council s Audit Quality Review team following inspection of KPMG s 2014 audit. The Committee discussed the actions undertaken by KPMG as part of their 2015 audit to address the matters raised. It agreed that any identified areas for further improvement had been addressed or had appropriate action plans in place.

On completion of the activities outlined above, the Committee concluded that the audit had been effective and the challenge appropriately robust across all parts of the Group.

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The Committee has responsibility for monitoring auditor independence and objectivity and is supported in doing so by the Group s Auditor Independence Policy (the Policy). The Policy is updated annually and approved by the Committee. It sets out the circumstances in which the external auditor may be permitted to undertake non-audit services and is based on four key principles which specify that the auditor should not:

**Auditor** 

independence and

objectivity

Audit its own firm s work;

Make management decisions for the Group;

Have a mutuality of financial interest with the Group; or

Be put in the role of advocate for the Group.

The Policy has two permissible service types: those that require specific approval by the Committee on an engagement basis and those that are pre-approved by the Committee with an annual monetary limit. In accordance with the Policy, the Committee approved these permissible services, classified as either audit or non-audit services, and monitored the usage of the annual limits on a quarterly basis. All non-audit services undertaken by KPMG were agreed prior to the commencement of work and were confirmed as permissible for the external auditor to undertake under the provisions of the Sarbanes-Oxley Act. In November 2016, the Committee considered and approved revisions to the Policy with effect from 1 January 2017, to reflect final rules and guidance issued by the Financial Reporting Council, in connection with the implementation of broader European Union (EU) reforms to the audit market. The most significant change was to reduce the annual monetary limits for services that are pre-approved by the Committee.

These revisions build on the previous year s updates, where amendments to the Policy were made to ensure the schedule of prohibited non-audit services was in line with the EU reforms referenced above. These changes were effective throughout 2016.

In keeping with professional ethical standards, KPMG also confirmed their independence to the Committee and set out the supporting evidence for their conclusion in a report that was considered by the Committee prior to publication of the financial results.

# Fees paid to the auditor

The fees paid to KPMG for the year ended 31 December 2016 amounted to £16.2 million (2015: £16.6 million) of which £2.8 million (2015: £4.3 million) was payable in respect of non-audit services. Non-audit services accounted for 17 per cent of total fees payable (2015: 26 per cent).

A breakdown of the fees paid to KPMG can be found in Note B3.4 to the financial statements on page 284.

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# **Matter considered**

# How the Committee addressed the matter

# Reappointment

Of the £2.8 million of non-audit services, the principal types of non-audit engagements approved for 2016 were other assurance services of £2.7 million (of which £1.5 million related to Solvency II reporting and disclosures) and other non-audit services of £0.6 million.

Based on the outcome of the effectiveness evaluation and all other considerations, the Committee recommended that KPMG be reappointed as the auditor. A resolution to this effect will be proposed to shareholders at the 2017 Annual General Meeting.

The external audit was last put out to competitive re-tender in 1999 when the present auditor, KPMG, was appointed. Since 2005, the Committee has annually considered the need to re-tender the external audit service and it again considered this in May 2016, concluding that there was nothing in the performance of the auditor which required such a tender.

The Committee acknowledges the provisions contained in the UK Code in respect of audit tendering, along with European rules on mandatory audit rotation and audit tendering. In conformance with these requirements, the Company will be required to change audit firm no later than for the 2023 financial year end. The Committee also recognises that the industry is in a period of unprecedented change with the IASB expecting to issue a new insurance accounting standard in 2017, for implementation in 2021. The Committee currently believes any change of auditor should be scheduled to limit operational disruption during such a period of change and, as a consequence, is not currently planning to re-tender the audit before the adoption of IFRS 17. This remains subject to the Committee s normal annual review.

The Company has complied throughout the 2016 financial year with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 issued by the Competition and Markets Authority.

In line with the Auditing Practices Board Ethical Statements and the Sarbanes-Oxley Act, a new lead audit partner is appointed every five years. A new lead audit partner was appointed in respect of the 2012 financial year who will be replaced following the completion of this 2016 reporting cycle. The replacement lead audit partner has been identified.

The Committee is responsible for approval of the internal audit programme and monitoring the effectiveness of the internal audit function.

The independent assurance provided by Group-wide Internal Audit (GwIA) formed a fundamental part of the Committee s deliberations on the Group s

overall control environment. The Committee received regular updates on

Audit tender

Third line oversight internal audit
Regular reporting

audits conducted and management s progress in addressing audit findings. Each of the Group s business units has an internal audit team, the heads of which report to the Director of Group-wide Internal Audit. The function also has a Quality Assurance Director, whose primary role is to monitor and evaluate adherence to industry practice guidelines and Group-wide adherence to GwIA s own standards and methodology. Internal audit resources, plans, budgets and its work, including the function s annual review of the control environment and risk, and control

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# **Matter considered**

# How the Committee addressed the matter

culture of the organisation, are overseen by both the Committee and the relevant business unit audit committee. The Director of GwIA reports functionally to the Chairman of the Committee and for management purposes to the Group Chief Executive, and also has direct access to the Chairman of the Board. In addition to formal Committee meetings, the Committee meets with the Director of GwIA in private to discuss matters relating to, for example, the effectiveness of the internal audit function, significant audit findings and the risk and control culture of the organisation. The Committee approved the half year update of the 2016 plan. It also considered and approved the Internal Audit Plan, resource and budget for 2017.

# Annual plan and focus for 2017

At the half year, the Committee considered recommendations to refresh the Internal Audit Plan in response to changes in the business unit operating environments and an update to the Group's top risks. The 2017 Internal Audit Plan was formulated based on a bottom-up risk assessment of audit needs mapped against various metrics combined with top-down challenge by the GwIA Leadership Team and executive management at business unit and Group level. The plan was then mapped against a series of risk and control parameters, including the top risks identified by the Risk Committee, to verify that it is appropriately balanced between financial, business change, regulatory and operational risk drivers and provides appropriate coverage of key risk areas and audit themes within a risk-based cycle of coverage. Key areas of focus for 2017 include programme assurance, cyber security, outsourcing arrangements, customer outcomes and governance.

The Committee assesses the effectiveness through a combination of external

# **Internal audit effectiveness**

effectiveness reviews, required every five years (last conducted in 2012), and an annual internal effectiveness review, performed by the GwIA Quality Assurance Director. In 2016, Deloitte assessed the overall GwIA annual planning approach and the quality of audit work and concluded that the function is a well-developed group function that applies a number of leading practices on a consistent basis across the Prudential Group, including advanced data analytics capabilities and well embedded approaches for conducting audits . In addition, an internal effectiveness review was conducted in 2016, in accordance with the professional practice standards of the Chartered Institute of Internal Auditors (CIIA). This review concluded that GwIA continues to comply with the requirements of internal audit policies, procedures and practices, and standards in all material respects relating to audit planning and execution, and continued to be aligned with its mandated objectives and maintained general conformance with the CIIA guidance for Effective Internal Audit in the Financial Services Sector. Having considered the findings of Deloitte s review and the 2016 internal effectiveness review, the Committee concluded that GwIA had continued to operate in compliance with the requirements of GwIA policies, procedures and practice standards in all material respects and had remained aligned to

F	Business	unit	audit	committee
e	ffective	ness		

mandated objectives during 2016.

The Committee is supported by the work carried out by the material subsidiary and other business unit audit committees and annually reviews the effectiveness of these committees in meeting their defined terms of reference. These audit committees provide oversight of the respective business units. During the year, membership of the committees for all

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# **Matter considered**

# How the Committee addressed the matter

material subsidiaries has been changed to comprise solely of independent non-executive directors. The minutes of all business unit audit committees were provided to the Committee and their meetings were attended by the external auditor, as well as senior management from the business unit (including the Business Unit Chief Executive, heads of Finance, Risk, Compliance and GwIA) and from Group Head Office. In addition, the Committee chairman meets in person or telephonically at least quarterly with the chairs of each of the material subsidiary audit committees.

Business unit model terms of reference

Second line
oversight compliance, financial
crime prevention, whistleblowing

Regular reporting from Compliance Compliance Plan and focus for 2017

Financial crime prevention

The Committee s assessment of these committees was supported by local teams from GwIA and considered whether each of the committees fulfilled the responsibilities documented in their terms of reference. Attendance rates by audit committee members and evidence of the audit committees coverage of key business unit issues, as well as the appropriate escalation of concerns to the Committee, formed part of the criteria used for the evaluation. The Committee approved the Group's standard terms of reference for the material subsidiary and other business unit audit committees, which were updated to reflect changes in the Committee's own responsibilities to align them with best practice, as well as the change in membership for the material subsidiaries. These were adopted by the business unit audit committees with minor variations to address local regulations or the particular requirements of the business.

Regular updates were provided to the Committee by the Group Regulatory and Government Affairs Director and the Group Compliance Director. The reports kept the Committee apprised of key compliance activities, issues and controls, including progress against the 2016 Compliance Plan, the outcome of compliance monitoring activities across the Group and the effectiveness of business unit compliance departments.

The Committee considered and approved the 2017 Group Compliance Plan. Areas of focus included strengthening the compliance framework, enhancing compliance monitoring arrangements and mitigation of key risks, including conflicts of interest, the fair treatment of customers and anti-money laundering and sanctions. Following the external review of the effectiveness of compliance monitoring, the Plan includes developing a more consistent approach to the planning, execution and reporting of compliance monitoring activity across the Group.

The Committee received the Money Laundering Prevention Officer's report which assessed the operation and effectiveness of the Group's systems and controls in relation to managing money laundering and sanctions risk. The Committee noted the regulatory developments relating to initiatives by the Financial Action Task Force and the 4<sup>th</sup> EU Anti-Money Laundering Directive.

# Whistleblowing Whistleblowing Whistleblowing

An external review of the Group s anti-bribery and corruption programme was undertaken this year and the Committee noted the recommendations being taken forward by management.

The Committee noted the launch of an enhanced, Group-wide whistleblowing programme ( Speak Out ), reflecting UK regulatory changes and the Group s geographic expansion. The programme captures and comprehensively records matters raised through the Group s

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# **Matter considered**

# How the Committee addressed the matter

Confidential Reporting process. Throughout the year, the Committee has continued to receive regular updates on such matters and the actions taken to address them.

The role of the whistleblowing champion, for the purpose of the Senior Insurance Managers Regime, will be carried out by the chair of the UK business unit risk committee. At Group level, the Chair of the Audit Committee remains responsible for oversight of whistleblowing activities across the whole of the Group.

Internal control

The Committee is responsible for reporting and making recommendations to the Board on the effectiveness of Group-wide internal control and risk management systems.

Internal control and risk management systems

The Committee considered the outcome of the annual review of the systems of internal control and risk management. The report considered all material controls, including financial, operational and compliance controls and reflected changes in the HK Code which became effective for financial years commencing on or after 1 January 2016. Having considered the review, the Committee made recommendations to the Board regarding the ongoing processes and effectiveness of the risk management and internal control systems in place.

# Governance

# **Group Governance Framework**

The Group Governance Manual sets out the policies and processes by which the Group operates within its framework of internal governance, taking into account relevant statutory and regulatory matters. Used as a platform for mandating specific ways of working across the Group, each business unit attests annually to compliance with:

Mandatory requirements set out in Group-wide policies;

Matters requiring prior approval from those parties with delegated authority; and

Matters which must be reported to the Group Functions.

The Committee reviewed the results of the Group Governance Manual annual content review to ensure its continued effectiveness and long-term value to the Group, and the results of the year end certification of

Committee effectiveness	compliance with Group Governance Manual requirements for the period ended 31 December 2016.  A review of the Committee s activities was conducted against applicable regulation and codes of conduct. The results of this assessment were provided to the Committee alongside the outcome of the part of the annual
	Board evaluation relating to the Committee.

# **Risk Committee report**

This report describes how the Risk Committee has fulfilled its duties under its terms of reference during the year.

The Committee assists the Board in providing leadership, direction and oversight of the Group s overall risk appetite and limits, risk strategy and risk culture. The Committee also oversees and advises the Board on current and future risk exposures of the Group, including those which have the potential to impact on the delivery of the Group s business plan. The Committee reviews and approves the Group Risk Framework and monitors its appropriateness in identifying and managing the risks faced by the Group.

The Committee met on eight occasions during the year. The Committee works closely with the Audit Committee to ensure both Committees are updated on matters which impact on their responsibilities. Where a matter requires

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input from both Committees, joint meetings are held with the Audit Committee. In 2016, one joint meeting with the Audit Committee took place to discuss the Solvency II capital position as at 31 December 2015 and associated governance processes.

During 2016, the Committee reviewed the Group s risk policies and updated the Group s risk appetite limits to reflect changes in the Group s risk profile and the evolving regulatory and macroeconomic environments. The Committee also reviewed the principal risks facing the Group and received regular updates on these through the course of the year. The Committee received regular reports from the Chief Risk Officers of the material subsidiaries.

Over 2016, the Committee continued to focus on the key risks arising from the products Prudential offers to customers, the risks inherent in the Group s investment portfolios, and the operational risks that arise from operating the businesses. The Committee regularly reviewed the strength of the Group s capital and liquidity positions, and the significant ongoing changes to the regulatory framework and environment. In addition, the Committee closely monitored risks arising from the macroeconomic environment and regulatory developments such as the risks relating to prolonged low interest rates and the pace of regulatory developments across the globe.

During 2016, the Committee oversaw the work required as a result of the Group s continuing designation as a Global Systemically Important Insurer, including the development of the Systemic Risk Mitigation Plan, the Liquidity Risk Mitigation Plan and the Recovery Plan. The Committee also considered the methodology underpinning and validation of the Group s Solvency II internal model, oversaw the delivery of the Group s major Model Change application to the PRA, and risks arising from the Solvency II regime.

The Committee provided oversight of the Group s planning for, and response to, the results in the Brexit referendum and US presidential election that have driven increased uncertainty in markets and the macroeconomic environment. The Committee reviewed in depth the risk arising from the business, including examining the hedging programme in Jackson, and persistency and policyholder behaviour risks across the Group. Other areas of focus in 2016 included reviewing the Group s cyber defence resilience and defence strategy, and reviewing the effectiveness of the risk management functions across the Group. The Committee commissioned a number of deep dive reviews to support these areas, and monitored the implementation of recommendations arising.

The Committee also refined governance processes during the year to enhance the information the Committee receives on the activities of the Group s business unit risk committees and ensure key issues are escalated appropriately. The Chairman of the Committee maintains regular contact with the risk committee chairs of the Group s material subsidiaries and reports to the Committee on issues discussed.

Looking forward into 2017, the Committee will remain focused on monitoring the Group s principal risks and those posed by regulatory developments and macroeconomic conditions. The Committee approved the 2017 plans for the Risk function, and will continue to adapt the plan of work to respond to any changes in the business environment or the Group s strategy.

The Chairman of the Committee has responsibility for ensuring the Committee operates effectively. To ensure it does so and provide constructive challenge to management, open debate and contributions from all Committee members are encouraged by the Chairman of the Committee. An annual review of the Committee s effectiveness was carried out as part of the Board evaluation, described in more detail on pages 147 and 148. The Committee was found to be functioning effectively.

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Committee members	Regular attendees
Howard Davies (Chairman)	Chairman of the Board
Ann Godbehere	Group Chief Executive
Kai Nargolwala	Group Chief Risk Officer
Lord Turner	Chief Financial Officer
	Group Regulatory and Government Relations Director
	Group General Counsel and Company Secretary
	Director of Group-wide Internal Audit

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Number of meetings in 2016: eight (in addition, a joint meeting was held with the Audit Committee)

How the Committee spent its time during 2016

The table below provides an overview of how the Committee spent its time in 2016.

Feb Apr May Jul Sep Oct Nov Markets and Group risk updates