

PRUDENTIAL PLC
Form 6-K
March 11, 2015

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER

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

For the month of March, 2015

PRUDENTIAL PUBLIC LIMITED COMPANY

(Translation of registrant's name into English)

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

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

Form 20-F Form 40-F

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

Yes No

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

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED INCOME STATEMENT

| Year ended 31 December | Note | 2014 £m | 2013 £m |
|---------------------------------------------------------------------------------------------------|------|----------|----------|
| Gross premiums earned | | 32,832 | 30,502 |
| Outward reinsurance premiums | | (799) | (658) |
| Earned premiums, net of reinsurance | | 32,033 | 29,844 |
| Investment return | | 25,787 | 20,347 |
| Other income | | 2,306 | 2,184 |
| Total revenue, net of reinsurance | | 60,126 | 52,375 |
| Benefits and claims | | (50,736) | (42,227) |
| Outward reinsurers' share of benefit and claims | | 631 | 622 |
| Movement in unallocated surplus of with-profits funds | | (64) | (1,549) |
| Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance | | (50,169) | (43,154) |
| Acquisition costs and other expenditure | B3 | (6,752) | (6,861) |
| Finance costs: interest on core structural borrowings of shareholder-financed operations | | (341) | (305) |
| Remeasurement of carrying value of Japan life business classified as held for sale | D1 | (13) | (120) |
| Total charges, net of reinsurance | | (57,275) | (50,440) |
| Share of profits from joint ventures and associates, net of related tax | | 303 | 147 |
| Profit before tax | | | |
| (being tax attributable to shareholders' and policyholders' returns)* | | 3,154 | 2,082 |
| Less tax charge attributable to policyholders' returns | | (540) | (447) |
| Profit before tax attributable to shareholders | B1.1 | 2,614 | 1,635 |
| Total tax charge attributable to policyholders and shareholders | B5 | (938) | (736) |
| Adjustment to remove tax charge attributable to policyholders' returns | | 540 | 447 |
| Tax charge attributable to shareholders' returns | B5 | (398) | (289) |
| Profit for the year attributable to equity holders of the Company | | 2,216 | 1,346 |
| Earnings per share (in pence) | | 2014 | 2013 |
| Based on profit attributable to the equity holders of the Company: | B6 | | |
| Basic | | 86.9p | 52.8p |
| Diluted | | 86.8p | 52.7p |
| Dividends per share (in pence) | | 2014 | 2013 |
| Dividends relating to reporting year: | B7 | | |
| Interim dividend | | 11.19p | 9.73p |
| Final dividend | | 25.74p | 23.84p |

| | | | |
|------------------------------------------------|----|--------|--------|
| Total | | 36.93p | 33.57p |
| Dividends declared and paid in reporting year: | B7 | | |
| Current year interim dividend | | 11.19p | 9.73p |
| Final dividend for prior year | | 23.84p | 20.79p |
| Total | | 35.03p | 30.52p |

* 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.

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| Year ended 31 December | Note | 2014 £m | 2013 £m |
|---------------------------------------------------------------------------------------------------------------|---------|---------|---------|
| Profit for the year | | 2,216 | 1,346 |
| Other comprehensive income: | | | |
| Items that may be reclassified subsequently to profit or loss | | | |
| Exchange movements on foreign operations and net investment hedges: | | | |
| Exchange movements arising during the year | | 215 | (255) |
| Related tax | | 5 | - |
| | | 220 | (255) |
| Net unrealised valuation movements on securities of US insurance operations classified as available-for-sale: | | | |
| Net unrealised holding gains (losses) arising during the year | | 1,039 | (2,025) |
| Net losses included in the income statement on disposal and impairment | | (83) | (64) |
| Total | C3.3 | 956 | (2,089) |
| Related change in amortisation of deferred acquisition costs | C5.1(b) | (87) | 498 |
| Related tax | | (304) | 557 |
| | | 565 | (1,034) |
| Total | | 785 | (1,289) |
| Items that will not be reclassified to profit or loss | | | |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes: | | | |
| Gross | | (12) | (62) |
| Related tax | | 2 | 14 |

| | | |
|--------------------------------------------------------------------|-------|---------|
| | (10) | (48) |
| Other comprehensive income (loss) for the year, net of related tax | 775 | (1,337) |
| Total comprehensive income for the year | 2,991 | 9 |

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | Year ended 31 December 2014 £m | | | | | | | Total equity |
|-------------------------------------------------------------------------------------------------------------------------|--------------------------------|------------------------|-------------------|---------------------|----------------------------------------|----------------------|---------------------------|--------------|
| | Share capital note | Share premium note C10 | Retained earnings | Translation reserve | Available-for-sale securities reserves | Shareholders' equity | Non-controlling interests | |
| Reserves | | | | | | | | |
| Profit for the year | - | - | 2,216 | - | - | 2,216 | - | 2,216 |
| Other comprehensive income: | | | | | | | | |
| Exchange movements on foreign operations and net investment hedges, net of related tax | - | - | - | 220 | - | 220 | - | 220 |
| Net unrealised valuation movements, net of related change in amortisation of deferred acquisition costs and related tax | - | - | - | - | 565 | 565 | - | 565 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, net of tax | - | - | (10) | - | - | (10) | - | (10) |
| Total other comprehensive income | - | - | (10) | 220 | 565 | 775 | - | 775 |
| Total comprehensive income for the year | - | - | 2,206 | 220 | 565 | 2,991 | - | 2,991 |
| Dividends | B7 | - | (895) | - | - | (895) | - | (895) |
| | | - | 106 | - | - | 106 | - | 106 |

| | | | | | | | | |
|------------------------------------------------------------------------------------|-----|-------|-------|-------|-----|--------|---|--------|
| Reserve movements in respect of share-based payments | | | | | | | | |
| Change in non-controlling interests | - | - | - | - | - | - | - | - |
| Share capital and share premium | | | | | | | | |
| New share capital subscribedC10 | - | 13 | - | - | - | 13 | - | 13 |
| Treasury shares | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | - | - | (48) | - | - | (48) | - | (48) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | - | - | (6) | - | - | (6) | - | (6) |
| Net increase (decrease) in equity | - | 13 | 1,363 | 220 | 565 | 2,161 | - | 2,161 |
| At beginning of year | 128 | 1,895 | 7,425 | (189) | 391 | 9,650 | 1 | 9,651 |
| At end of year | 128 | 1,908 | 8,788 | 31 | 956 | 11,811 | 1 | 11,812 |

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | Year ended 31 December 2013 £m | | | | | | | | |
|-------------------------------------------------------------------------------------------------------------------------|--------------------------------|------------------------------|------------------------------|-------------------|---------------------|-----------------------------------------|----------------------|---------------------------|--------------|
| | Note | Share capital note C10 | Share premium note C10 | Retained earnings | Translation reserve | Available -for-sale securities reserves | Shareholders' equity | Non-controlling interests | Total equity |
| Reserves | | | | | | | | | |
| Profit for the year | - | - | 1,346 | - | - | 1,346 | - | 1,346 | |
| Other comprehensive loss: | | | | | | | | | |
| Exchange movements on foreign operations and net investment hedges, net of related tax | - | - | - | (255) | - | (255) | - | (255) | |
| Net unrealised valuation movements, net of related change in amortisation of deferred acquisition costs and related tax | - | - | - | - | (1,034) | (1,034) | - | (1,034) | |

| | | | | | | | | | |
|------------------------------------------------------------------------------------------------------------|-----|-----|-------|-------|-------|---------|---------|-----|---------|
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, net of tax | | - | - | (48) | - | - | (48) | - | (48) |
| Total other comprehensive loss | | - | - | (48) | (255) | (1,034) | (1,337) | - | (1,337) |
| Total comprehensive income (loss) for the year | | - | - | 1,298 | (255) | (1,034) | 9 | - | 9 |
| Dividends | B7 | - | - | (781) | - | - | (781) | - | (781) |
| Reserve movements in respect of share-based payments | | - | - | 98 | - | - | 98 | - | 98 |
| Change in non-controlling interests | | - | - | - | - | - | - | (4) | (4) |
| Share capital and share premium | | | | | | | | | |
| New share capital subscribed | C10 | - | 6 | - | - | - | 6 | - | 6 |
| Treasury shares | | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | | - | - | (10) | - | - | (10) | - | (10) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | - | - | (31) | - | - | (31) | - | (31) |
| Net increase (decrease) in equity | | - | 6 | 574 | (255) | (1,034) | (709) | (4) | (713) |
| At beginning of year | | 128 | 1,889 | 6,851 | 66 | 1,425 | 10,359 | 5 | 10,364 |
| At end of year | | 128 | 1,895 | 7,425 | (189) | 391 | 9,650 | 1 | 9,651 |

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| 31 December | Note | 2014 £m | 2013 £m |
|--------------------------------------------------------|---------|---------|---------|
| Assets | | | |
| Intangible assets attributable to shareholders: | | | |
| Goodwill | C5.1(a) | 1,463 | 1,461 |
| Deferred acquisition costs and other intangible assets | C5.1(b) | 7,261 | 5,295 |
| Total | | 8,724 | 6,756 |

Intangible assets attributable to with-profits funds:

| | | | |
|---------------------------------------------------------------------------------------------|--|-----|-----|
| Goodwill in respect of acquired subsidiaries for venture fund and other investment purposes | | 186 | 177 |
| Deferred acquisition costs and other intangible assets | | 61 | 72 |
| Total | | 247 | 249 |

| | | | |
|-------------------------|--|-------|-------|
| Total intangible assets | | 8,971 | 7,005 |
|-------------------------|--|-------|-------|

Other non-investment and non-cash assets:

| | | | |
|-----------------------------------------------------|----|--------|--------|
| Property, plant and equipment | | 978 | 920 |
| Reinsurers' share of insurance contract liabilities | | 7,167 | 6,838 |
| Deferred tax assets | C8 | 2,765 | 2,412 |
| Current tax recoverable | | 117 | 244 |
| Accrued investment income | | 2,667 | 2,609 |
| Other debtors | | 1,852 | 1,746 |
| Total | | 15,546 | 14,769 |

Investments of long-term business and other operations:

| | | | |
|-----------------------------------------------------------------------------------|------|---------|---------|
| Investment properties | | 12,764 | 11,477 |
| Investment in joint ventures and associates accounted for using the equity method | | 1,017 | 809 |
| Financial investments:* | | | |
| Loans | C3.4 | 12,841 | 12,566 |
| Equity securities and portfolio holdings in unit trusts | | 144,862 | 120,222 |
| Debt securities | C3.3 | 145,251 | 132,905 |
| Other investments | | 7,623 | 6,265 |
| Deposits | | 13,096 | 12,213 |
| Total | | 337,454 | 296,457 |

| | | | |
|----------------------|-------|-----|-----|
| Assets held for sale | D1(b) | 824 | 916 |
|----------------------|-------|-----|-----|

| | | | |
|---------------------------|--|-------|-------|
| Cash and cash equivalents | | 6,409 | 6,785 |
|---------------------------|--|-------|-------|

| | | | |
|--------------|---------|---------|---------|
| Total assets | C1,C3.1 | 369,204 | 325,932 |
|--------------|---------|---------|---------|

* Included within financial investments are £4,578 million (2013: £3,791 million) of lent securities.

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| 31 December | Note | 2014 £m | 2013 £m |
|---------------------------|------|---------|---------|
| Equity and liabilities | | | |
| Equity | | | |
| Shareholders' equity | | 11,811 | 9,650 |
| Non-controlling interests | | 1 | 1 |
| Total equity | | 11,812 | 9,651 |

Liabilities

Policyholder liabilities and unallocated surplus of with-profits funds:

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| | | | |
|--------------------------------------------------------------------------------------------|---------|---------|---------|
| Insurance contract liabilities | | 250,038 | 218,185 |
| Investment contract liabilities with discretionary participation features | | 39,277 | 35,592 |
| Investment contract liabilities without discretionary participation features | | 20,224 | 20,176 |
| Unallocated surplus of with-profits funds | | 12,450 | 12,061 |
| Total | C4 | 321,989 | 286,014 |
| Core structural borrowings of shareholder-financed operations: | | | |
| Subordinated debt | | 3,320 | 3,662 |
| Other | | 984 | 974 |
| Total | C6.1 | 4,304 | 4,636 |
| Other borrowings: | | | |
| Operational borrowings attributable to shareholder-financed operations | C6.2 | 2,263 | 2,152 |
| Borrowings attributable to with-profits operations | C6.2 | 1,093 | 895 |
| Other non-insurance liabilities: | | | |
| Obligations under funding, securities lending and sale and repurchase agreements | | 2,347 | 2,074 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | | 7,357 | 5,278 |
| Deferred tax liabilities | C8 | 4,291 | 3,778 |
| Current tax liabilities | C8 | 617 | 395 |
| Accruals and deferred income | | 947 | 824 |
| Other creditors | | 4,262 | 3,307 |
| Provisions | | 724 | 635 |
| Derivative liabilities | | 2,323 | 1,689 |
| Other liabilities | | 4,105 | 3,736 |
| Total | | 26,973 | 21,716 |
| Liabilities held for sale | | 770 | 868 |
| Total liabilities | C1,C3.1 | 357,392 | 316,281 |
| Total equity and liabilities | | 369,204 | 325,932 |

International Financial Reporting Standards (IFRS) Basis Results

CONSOLIDATED STATEMENT OF CASH FLOWS

| Year ended 31 December | Note | 2014 £m | 2013 £m |
|-------------------------------------------------------------------------------------------------------|------|----------|----------|
| Cash flows from operating activities | | | |
| Profit before tax (being tax attributable to shareholders' and policyholders' returns) note (i) | | 3,154 | 2,082 |
| Non-cash movements in operating assets and liabilities reflected in profit before tax: | | | |
| Investments | | (30,746) | (23,487) |
| Other non-investment and non-cash assets | | (1,521) | (1,146) |
| Policyholder liabilities (including unallocated surplus) | | 27,292 | 21,951 |
| Other liabilities (including operational borrowings) | | 3,797 | 1,907 |

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| | | | |
|-------------------------------------------------------------------------------|------|---------|---------|
| Interest income and expense and dividend income included in result before tax | | (8,315) | (8,345) |
| Other non-cash items:note (ii) | | 174 | 81 |
| Operating cash items: | | | |
| Interest receipts | | 7,155 | 6,961 |
| Dividend receipts | | 1,559 | 1,738 |
| Tax paid | | (721) | (418) |
| Net cash flows from operating activities | | 1,828 | 1,324 |
| Cash flows from investing activities | | | |
| Purchases of property, plant and equipment | | (172) | (221) |
| Proceeds from disposal of property, plant and equipment | | 10 | 42 |
| Acquisition of subsidiaries and distribution rights, net of cash balance | D1 | (535) | (405) |
| Sale of PruHealth and PruProtect business:note (iii) | D1 | 152 | - |
| Net cash flows from investing activities | | (545) | (584) |
| Cash flows from financing activities | | | |
| Structural borrowings of the Group: | | | |
| Shareholder-financed operations:note (iv) | C6.1 | | |
| Issue of subordinated debt, net of costs | | - | 1,124 |
| Redemption of subordinated debt | | (445) | - |
| Interest paid | | (330) | (291) |
| With-profits operations:note (v) | C6.2 | | |
| Interest paid | | (9) | (9) |
| Equity capital: | | | |
| Issues of ordinary share capital | | 13 | 6 |
| Dividends paid | | (895) | (781) |
| Net cash flows from financing activities | | (1,666) | 49 |
| Net (decrease) increase in cash and cash equivalents | | (383) | 789 |
| Cash and cash equivalents at beginning of year | | 6,785 | 6,126 |
| Effect of exchange rate changes on cash and cash equivalents | | 7 | (130) |
| Cash and cash equivalents at end of year | | 6,409 | 6,785 |

Notes

- (i) This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.
- (ii) Other non-cash items consist of the adjustment of non-cash items to profit before tax together with other net items, net purchases of treasury shares and other net movements in equity.
- (iii) In November 2014 PAC sold its 25 per cent equity stake in the PruHealth and PruProtect business to Discovery Group Europe Limited resulting in a net cash inflow of £152 million.
- (iv) Structural borrowings of shareholder-financed operations exclude borrowings to support short-term fixed income securities programmes, non-recourse borrowings of investment subsidiaries of shareholder-financed operations and other borrowings of shareholder-financed operations. Cash flows in respect of these borrowings are included within cash flows from operating activities.
- (v) Interest paid on structural borrowings of with-profits operations relate solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds, which contribute to the solvency base of the Scottish Amicable Insurance Fund (SAIF), a ring-fenced sub-fund of the PAC with-profits fund. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

International Financial Reporting Standards (IFRS) Basis Results

NOTES

A BACKGROUND

A1 Basis of preparation and exchange rates

These statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU) as required by EU law (IAS Regulation EC1606/2032). EU-endorsed IFRS may differ from IFRS issued by the IASB if, at any point in time, new or amended IFRS have not been endorsed by the EU. At 31 December 2014, there were no unendorsed standards effective for the two years ended 31 December 2014 affecting the consolidated financial information of the Group and there were no differences between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to the Group. Except for the adoption of the new and amended accounting standards for Group IFRS reporting as described in note A2 below, the accounting policies applied by the Group in determining the IFRS basis results in this report are the same as those previously applied in the Group's consolidated financial statements for the year ended 31 December 2013.

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

| | Closing rate at 31 Dec 2014 | Average rate for 2014 | Closing rate at 31 Dec 2013 | Average rate for 2013 |
|-------------------|-----------------------------------|-----------------------------|-----------------------------------|-----------------------------|
| Local currency: £ | | | | |
| Hong Kong | 12.09 | 12.78 | 12.84 | 12.14 |
| Indonesia | 19,311.31 | 19,538.56 | 20,156.57 | 16,376.89 |
| Malaysia | 5.45 | 5.39 | 5.43 | 4.93 |
| Singapore | 2.07 | 2.09 | 2.09 | 1.96 |
| India | 98.42 | 100.53 | 102.45 | 91.75 |
| Vietnam | 33,348.46 | 34,924.62 | 34,938.60 | 32,904.71 |
| Thailand | 51.30 | 53.51 | 54.42 | 48.11 |
| US | 1.56 | 1.65 | 1.66 | 1.56 |

Certain notes to the financial statements present 2013 comparative information at Constant Exchange Rates, in addition to the reporting at Actual Exchange Rates used throughout the consolidated financial statements. 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 ie current period average rates for the income statement and current period closing rates for the balance sheet.

The financial information set out in this announcement does not constitute the Company's statutory accounts for the years ended 31 December 2014 or 2013 but is derived from those accounts. The auditors have reported on the 2014 statutory accounts. Statutory accounts for 2013 have been delivered to the registrar of companies, and those for 2014 will be delivered following the Company's Annual General Meeting. Their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

A2 Adoption of new accounting pronouncements in 2014

The Group has adopted the following accounting pronouncements in 2014 but their adoption has had no material impact on the results and financial position of the Group:

- Amendments to IAS 32: Offsetting financial assets and financial liabilities; and

- IFRIC 21, 'Levies.

This is not intended to be a complete list as only those accounting pronouncements that could have an impact upon the Group's financial statements are described.

B EARNINGS PERFORMANCE

B1 Analysis of performance by segment

B1.1 Segment results - profit before tax

| | | 2014 £m | 2013 £m | | % 2013 2013 AER CER vs vs 2014 2014 note (v) note (v) | |
|------------------------------------------------------------------------------|-------|------------|----------|----------|-------------------------------------------------------------------------|----------|
| | Note | | AER | CER | 2014 | 2014 |
| | | | note (v) | note (v) | (v) | note (v) |
| Asia operations | | | | | | |
| Insurance operations | B4(a) | 1,052 | 1,003 | 907 | 5% | 16% |
| Development expenses | | (2) | (2) | (2) | 0% | 0% |
| Total Asia insurance operations after development expenses | | 1,050 | 1,001 | 905 | 5% | 16% |
| Eastspring Investments | | 90 | 74 | 68 | 22% | 32% |
| Total Asia operations | | 1,140 | 1,075 | 973 | 6% | 17% |
| US operations | | | | | | |
| Jackson (US insurance operations) | B4(b) | 1,431 | 1,243 | 1,181 | 15% | 21% |
| Broker-dealer and asset management | | 12 | 59 | 56 | (80)% | (79)% |
| Total US operations | | 1,443 | 1,302 | 1,237 | 11% | 17% |
| UK operations | | | | | | |
| UK insurance operations: | | | | | | |
| Long-term business | B4(c) | 752 | 706 | 706 | 7% | 7% |
| General insurance commission note (i) | | 24 | 29 | 29 | (17)% | (17)% |
| Total UK insurance operations | | 776 | 735 | 735 | 6% | 6% |
| M&G (including Prudential Capital) | B2 | 488 | 441 | 441 | 11% | 11% |
| Total UK operations | | 1,264 | 1,176 | 1,176 | 7% | 7% |
| Total segment profit | | 3,847 | 3,553 | 3,386 | 8% | 14% |
| Other income and expenditure | | | | | | |
| Investment return and other income | | 15 | 10 | 10 | 50% | 50% |
| Interest payable on core structural borrowings | | (341) | (305) | (305) | (12)% | (12)% |
| Corporate expenditure note (ii) | | (293) | (263) | (263) | (11)% | (11)% |
| Total | | (619) | (558) | (558) | (11)% | (11)% |
| Solvency II implementation costs | | (28) | (29) | (29) | 3% | 3% |
| Restructuring costs note (iii) | | (14) | (12) | (12) | (17)% | (17)% |
| Operating profit based on longer-term investment returns | | 3,186 | 2,954 | 2,787 | 8% | 14% |
| Short-term fluctuations in investment returns on shareholder-backed business | B1.2 | (574) | (1,110) | (1,063) | 48% | 46% |
| Gain on sale of PruHealth and PruProtect note (iv) | D1 | 86 | - | - | n/a% | n/a% |

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| | | | | | | |
|--------------------------------------------------------------|----|-------|-------|-------|-------|-------|
| Amortisation of acquisition accounting adjustments note (vi) | | (79) | (72) | (68) | (10)% | (16)% |
| Loss attaching to held for sale Japan Life business | D1 | - | (102) | (89) | 100% | 100% |
| Costs of domestication of Hong Kong branch | D2 | (5) | (35) | (35) | 86% | 86% |
| Profit before tax attributable to shareholders | | 2,614 | 1,635 | 1,532 | 60% | 71% |

| | | 2014 | 2013 | % 2013 2013 AER CER vs vs 2014 2014 note | |
|-------------------------------------------------------------------|----|-------|-------|---------------------------------------------------------|---------|
| Basic earnings per share (in pence) | B6 | | | (v) | (v) |
| Based on operating profit based on longer-term investment returns | | 96.6p | 90.9p | 85.9p | 6% 12% |
| Based on profit for the year | | 86.9p | 52.8p | 49.8p | 65% 74% |

Notes

- (i) The Group's UK insurance operations transferred its general insurance business to Churchill in 2002. General insurance commission represents the commission receivable net of expenses for Prudential-branded general insurance products as part of this arrangement, which terminates at the end of 2016.
- (ii) Corporate expenditure as shown above is for Group Head Office and Asia Regional Head Office.
- (iii) Restructuring costs are incurred in the UK and represent one-off business development expenses.
- (iv) In November 2014, PAC completed the sale of its 25 per cent equity stake in the PruHealth and PruProtect business to Discovery Group Europe Limited.
- (v) For definitions of AER and CER refer to note A1.
- (vi) Amortisation of acquisition accounting adjustments principally relate to the acquired REALIC business of Jackson.

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

| | | 2014 £m | 2013 £m |
|-----------------------------|---------------|---------|---------|
| Insurance operations: | | | |
| | Asia note (i) | 178 | (204) |
| | US note (ii) | (1,103) | (625) |
| | UK note (iii) | 464 | (254) |
| Other operations: note (iv) | | (113) | (27) |
| Total | | (574) | (1,110) |

Notes

(i) Asia insurance operations

In Asia, the positive short-term fluctuations of £178 million (2013: negative £(204) million) primarily reflect net unrealised movements on bond holdings following falls in bond yields across the region during the year.

(ii) US insurance operations

The short-term fluctuations in investment returns for US insurance operations comprise amounts, net of related change in amortisation of deferred acquisition costs, in respect of the following items:

2014 £m 2013 £m

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| | | |
|---------------------------------------------------------|---------|-------|
| Net equity hedge resultnote (a) | (1,574) | (255) |
| Other than equity-related derivativesnote (b) | 391 | (531) |
| Debt securities note (c) | 47 | 42 |
| Equity-type investments: actual less longer-term return | 16 | 89 |
| Other items | 17 | 30 |
| Total | (1,103) | (625) |

The short-term fluctuations in investment returns shown in the table above are stated net of a credit for the related change in amortisation of deferred acquisition costs of £653 million (2013: credit of £228 million). See note C5.1(b).

Notes

(a) Net equity hedge result

This result comprises the net effect of:

- The accounting value movements on the variable and fixed index annuity guarantee liabilities;
- Fair value movements on free standing equity derivatives;
- Fee assessments and claim payments in respect of guarantee liabilities; and
- Related changes to DAC amortisation.

Movements in the accounting values of the variable and fixed index annuity guarantee liabilities comprise those for:

- The GMDB and GMWB "for life" guarantees which are valued under the US GAAP insurance measurement basis applied for IFRS in a way that substantially does not recognise the effect of equity market and interest rate changes. These represent the majority of the guarantees offered by Jackson; and
- GMWB "not for life" embedded derivative liabilities which are required to be fair valued. Fair value movements on these liabilities include the effects of changes to levels of equity markets, implied volatility and interest rates.

The free standing equity derivatives are held to manage equity exposures of the variable annuity and fixed index annuity guarantees.

The net equity hedge result therefore includes significant accounting mismatches and other factors that detract from the presentation of an economic result caused by:

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

(b) Other than equity-related derivatives

The fluctuations for this item comprise the net effect of:

- Fair value movements on free standing, other than equity related derivatives;
- Accounting effects of the GMIB and its reinsurance; and
- Related changes to DAC amortisation.

The free standing, other than equity-related derivatives, are held to manage interest rate exposures and durations within the general account and the variable annuity and fixed index annuity guarantees described in note (a) above.

The GMIB liability is valued using the US GAAP measurement basis applied for IFRS reporting in a way that substantially does not recognise the effects of market movements. Reinsurance arrangements are in place so as to essentially fully insulate Jackson from the GMIB exposure. Notwithstanding that the liability is essentially fully reinsured, as the reinsurance asset is net settled it is deemed a derivative under IAS 39 which requires fair valuation.

The fluctuations for this item therefore include significant accounting mismatches caused by:

- The fair value movements booked in the income statement on the derivative programme being in respect of the management of interest rate exposures of the variable and fixed index annuity business as well as the fixed annuity business guarantees and durations within the general account;
- Fair value movements on Jackson's debt securities of the general account being booked in other comprehensive income rather than the income statement; and
- The mixed measurement model that applies for the GMIB and its reinsurance.

(c) Short-term fluctuations related to debt securities

| | 2014 £m | 2013 £m |
|---------------------------------------------------------------------------------------------------------------------------------------|---------|---------|
| Short-term fluctuations relating to debt securities | | |
| Credits (charges) in the year: | | |
| Losses on sales of impaired and deteriorating bonds | (5) | (5) |
| Bond write downs | (4) | (8) |
| Recoveries / reversals | 19 | 10 |
| Total credits (charges) in the year | 10 | (3) |
| Less: Risk margin allowance deducted from operating profit based on longer-term investment returns | 78 | 85 |
| | 88 | 82 |
| Interest-related realised gains: | | |
| Arising in the year | 63 | 64 |
| Less: Amortisation of gains and losses arising in current and prior years to operating profit based on longer-term investment returns | (87) | (89) |
| | (24) | (25) |
| Related amortisation of deferred acquisition costs | (17) | (15) |
| Total short-term fluctuations related to debt securities | 47 | 42 |

Note

The debt securities of Jackson are held in the general account of the business. Realised gains and losses are recorded in the income statement with normalised returns included in operating profit with variations from year to year included in the short-term fluctuations category. The risk margin reserve charge for longer-term credit-related losses included in operating profit based on longer-term investment returns of Jackson for 2014 is based on an average annual risk margin reserve of 24 basis points (2013: 25 basis points) on average book values of US\$54.5 billion (2013: US\$54.4 billion) as shown below:

| | 2014 | | | 2013 | | |
|---------------------------------------------------------------------------------------------|--------------------|-----|----------------------|--------------------|-----|----------------------|
| Moody's rating category (or equivalent under NAIC ratings of mortgage-backed securities) | Average book value | RMR | Annual expected loss | Average book value | RMR | Annual expected loss |

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| | US\$m | % | US\$m | £m | US\$m | % | US\$m | £m |
|--------------|--------|------|-------|------|--------|------|-------|------|
| A3 or higher | 27,912 | 0.12 | (34) | (21) | 27,557 | 0.11 | (32) | (20) |
| Baa1, 2 or 3 | 24,714 | 0.25 | (62) | (38) | 24,430 | 0.25 | (62) | (40) |
| Ba1, 2 or 3 | 1,390 | 1.23 | (17) | (10) | 1,521 | 1.18 | (18) | (11) |
| B1, 2 or 3 | 385 | 3.04 | (12) | (7) | 530 | 2.80 | (15) | (9) |
| Below B3 | 92 | 3.70 | (4) | (2) | 317 | 2.32 | (7) | (5) |
| Total | 54,493 | 0.24 | (129) | (78) | 54,355 | 0.25 | (134) | (85) |

Related amortisation of deferred acquisition costs
(see below)

Risk margin reserve charge to operating profit for
longer-term credit related losses

| | | | | | |
|--|-------|------|--|-------|------|
| | 25 | 15 | | 25 | 16 |
| | (104) | (63) | | (109) | (69) |

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

In addition to the accounting for realised gains and losses described above for Jackson general account debt securities, included within the statement of other comprehensive income is a pre-tax credit for unrealised gains on debt securities classified as available-for-sale net of related change in amortisation of deferred acquisition costs of £869 million (2013: net unrealised losses of £(1,591) million). Temporary market value movements do not reflect defaults or impairments. Additional details of the movement in the value of the Jackson portfolio are included in note C3.3(b).

(iii) UK insurance operation

The positive short-term fluctuations in investment returns for UK insurance operations of £464 million (2013: negative £(254) million) include net unrealised movements on fixed income assets supporting the capital of the shareholder-backed annuity business, reflecting the fall in bond yields since the end of 2013.

(iv) Other

Short-term fluctuations in investment returns of other operations, were negative £(113) million (2013: negative £(27) million) representing unrealised value movements on investments and foreign exchange items.

(v) Default losse

The Group did not experience any default losses on its shareholder-backed debt securities portfolio in 2014 or 2013.

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

Operating segments

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
(including Curian)
- M&G (including Prudential Capital)

The Group's operating segments are also its reportable segments for the purposes of internal management reporting with the exception of Prudential Capital (PruCap) which has been incorporated into the M&G operating segment for the purposes of segment reporting.

Performance measure

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;
- Gain on the sale the Group's interest of PruHealth and PruProtect in 2014 as explained in note D1;
- 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 Japan Life business. See note D1 for further details; 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 return 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 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 (i.e. after allocated investment return and change 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 notes (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 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
- 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 2014, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £467 million (2013: £461 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 note (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 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, excluding assets of the Japan Life held for sale business, investments in equity securities held for non-linked shareholder-financed operations amounted to £932 million as at 31 December 2014 (2013: £571 million). The rates of return applied in the years 2014 and 2013 ranged from 2.73 per cent to 13.75 per cent with the rates applied varying by territory. These rates are determined after consideration by the Group's in-house economists of long-term expected real government bond returns, equity risk premium and long-term inflation. These rates are broadly stable from period to period but may be different between countries reflecting, for example, differing expectations of inflation in each territory. The assumptions are for returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

The longer-term investment returns for the Asia insurance joint ventures accounted for on 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.

(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):

- Fair value movements for equity-based derivatives;
- Fair value movements for embedded derivatives for Guaranteed Minimum Withdrawal Benefit 'not for life' and fixed index annuity business, and Guaranteed Minimum Income Benefit reinsurance (see below);
- Movements in accounts carrying value of Guaranteed Minimum Death Benefit and Guaranteed Minimum Withdrawal Benefit 'for life' and Guaranteed Minimum Income Benefit liabilities, for which, under the 'grandfathered' US

GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements;

- Fee assessments and claim payments, in respect of guarantee liabilities; and
- Related amortisation of deferred acquisition costs for each of the above items.

Embedded derivatives for variable annuity guarantee features

The Guaranteed Minimum Income Benefit 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 Guaranteed Minimum Income Benefit is economically reinsured the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

(iii) Other derivative value movements

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 PIMCO or 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.

Equity-type securities

As at 31 December 2014, the equity-type securities for US insurance non-separate account operations amounted to £1,094 million (2013: £1,118 million). For these operations, the longer-term rates of return for income and capital applied in 2014 and 2013, which reflect the combination of the average risk free rates over the period and appropriate risk premiums are as follows:

| | 2014 | 2013 |
|---------------------------------------------------------------------------------------------------|--------------|--------------|
| Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds | 6.2% to 6.7% | 5.7% to 6.8% |
| Other equity-type securities such as investments in limited partnerships and private equity funds | 8.2% to 8.7% | 7.7% to 9.0% |

(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 in PRIL and the PAC non-profit sub-fund after adjustments to allocate the following elements of the movement to the category of 'short-term fluctuations in investment returns':

- The impact on credit risk provisioning of actual upgrades and downgrades during the period;
- Credit experience compared to 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 to 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.

B2 Profit before tax - asset management operations

The profit included in the income statement in respect of asset management operations for the year is as follows:

| 2014 £m | 2013 £m |
|---------|---------|
|---------|---------|

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| | M&G | US note (iv) | Eastspring Investments | Total | Total |
|---------------------------------------------------------------------------|-------|-----------------|---------------------------|---------|---------|
| Revenue (excluding NPH broker-dealer fees) | 1,395 | 303 | 310 | 2,008 | 1,914 |
| NPH broker-dealer feesnote (i) | - | 503 | - | 503 | 504 |
| Gross revenue | 1,395 | 806 | 310 | 2,511 | 2,418 |
| Charges (excluding NPH broker-dealer fees) | (937) | (291) | (249) | (1,477) | (1,353) |
| NPH broker-dealer feesnote (i) | - | (503) | - | (503) | (504) |
| Gross charges | (937) | (794) | (249) | (1,980) | (1,857) |
| Share of profit from joint ventures and associates, net of related tax | 13 | - | 29 | 42 | 35 |
| Profit before tax | 471 | 12 | 90 | 573 | 596 |
| Comprising: | | | | | |
| Operating profit based on longer-term investment returnsnote (ii) | 488 | 12 | 90 | 590 | 574 |
| Short-term fluctuations in investment returns note (iii) | (17) | - | - | (17) | 22 |
| Profit before tax | 471 | 12 | 90 | 573 | 596 |

Notes

(i) The segment revenue of the Group's asset management operations includes:

NPH broker-dealer fees represent commissions received that are then paid on to the writing brokers on sales of investment products. To reflect their commercial nature the amounts are also wholly reflected as charges within the income statement. After allowing for these charges, there is no effect on profit from this item. The presentation in the table above shows separately the amounts attributable to this item so that the underlying revenue and charges can be seen.

(ii) M&G operating profit based on longer-term investment returns:

| | 2014 £m | 2013 £m |
|--------------------------------------------------------------------|---------|---------|
| Asset management fee income | 953 | 859 |
| Other income | 1 | 4 |
| Staff costs | (351) | (339) |
| Other costs | (203) | (166) |
| Underlying profit before performance-related fees | 400 | 358 |
| Share of associate results | 13 | 12 |
| Performance-related fees | 33 | 25 |
| Operating profit from asset management operations | 446 | 395 |
| Operating profit from Prudential Capital | 42 | 46 |
| Total M&G operating profit based on longer-term investment returns | 488 | 441 |

The revenue shown above for M&G of £987 million (2013: £888 million), comprising asset management fee, other income and performance-related fees, is different to the amount of £1,395 million shown in the main table of this note primarily due to the inclusion of the revenue of Prudential Capital of £104 million (2013: £144 million) in the latter. In addition, the £987 million (2013: £888 million) is after deducting commissions which would have been included as charges in the main table. The difference in the presentation of commission is aligned with how management reviews the business.

(iii) Short-term fluctuations in investment returns for M&G are primarily in respect of unrealised fair value movements on Prudential Capital's bond portfolio.

(iv) The US asset management results include a charge of £38 million related primarily to the refund of certain fees by Curian.

B3 Acquisition costs and other expenditure

| | 2014 £m | 2013 £m |
|---------------------------------------------------------------------------------------------|---------|---------|
| Acquisition costs incurred for insurance policies | (2,668) | (2,553) |
| Acquisition costs deferred less amortisation of acquisition costs | 916 | 566 |
| Administration costs and other expenditure | (4,486) | (4,303) |
| Movements in amounts attributable to external unit holders of consolidated investment funds | (514) | (571) |
| Total acquisition costs and other expenditure | (6,752) | (6,861) |

B4 Effect of changes and other accounting features on insurance assets and liabilities

The following features are of particular relevance to the determination of the 2014 results:

(a) Asia insurance operations

In 2014, the IFRS operating profit based on longer-term investment returns for Asia insurance operations included a profit of £49 million (2013: £44 million) representing a number of non-recurring items, none of which are individually significant.

(b) US insurance operations

Amortisation of deferred acquisition costs

Jackson applies a mean reversion technique for amortisation of deferred acquisition costs on variable annuity business which dampens the effects of short-term market movements on expected gross profits against which deferred acquisition costs are amortised. To the extent that the mean reversion methodology does not fully dampen the effects of market returns, there is a charge or credit for accelerated or decelerated amortisation. For 2014 there was a charge for accelerated amortisation of £13 million (2013: a credit for decelerated amortisation of £82 million) to the operating profit based on longer-term investment returns. See note C5.1(b) for further details.

Other

In 2013, Jackson revised its projected long-term separate account return from 8.4 per cent to 7.4 per cent net of external fund management fees. The effect of this change together with other assumption changes and recalibration of modelling of accounting values of guarantees gave rise to a net benefit of £6 million to profit before tax in 2013.

(c) UK insurance operations

Annuity business: allowance for credit risk

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

The weighted components of the bond spread over swap rates for shareholder-backed fixed and linked annuity business for PRIL, based on the asset mix at the these dates are shown below.

| 31 Dec 2014 (bps) | | 31 Dec 2013 (bps) | |
|-------------------|------------|-------------------|------------|
| Pillar 1 | | Pillar 1 | |
| regulatory | | regulatory | |
| basis | Adjustment | basis | Adjustment |
| | IFRS | | IFRS |

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| | | | | | | |
|--------------------------------------|-----|------|-----|-----|------|-----|
| Bond spread over swap rates note (i) | 143 | - | 143 | 133 | - | 133 |
| Credit risk allowance | | | | | | |
| Long-term expected defaults note | | | | | | |
| (ii) | 14 | - | 14 | 15 | - | 15 |
| Additional provisionsnote (iii) | 44 | (12) | 32 | 47 | (19) | 28 |
| Total credit risk allowance | 58 | (12) | 46 | 62 | (19) | 43 |
| Liquidity premium | 85 | 12 | 97 | 71 | 19 | 90 |

Notes

(i) Bond spread over swap rates reflect market observed data.

(ii) Long-term expected defaults are derived by applying Moody's data from 1970 to 2009 and the definition of the credit rating used is the second highest credit rating published by Moody's, Standard & Poor's and Fitch.

(iii) Additional provisions comprise credit risk premium, which is derived from Moody's data from 1970 to 2009, an allowance for a one-notch downgrade of the portfolio subject to credit risk and an additional allowance for short-term defaults.

The prudent Pillar 1 regulatory basis reflects the overriding objective of maintaining sufficient provisions and capital to ensure payments to policyholders can be made. The approach for IFRS aims to establish liabilities that are closer to 'best estimate'.

Movement in the credit risk allowance for PRIL

The movement during 2014 of the average basis points allowance for PRIL on Pillar 1 regulatory and IFRS bases are as follows:

| | Pillar 1 Regulatory basis Total (bps) | IFRS Total (bps) |
|-----------------------------------------------------|------------------------------------------------|---------------------|
| Total allowance for credit risk at 31 December 2013 | 62 | 43 |
| Credit rating changes | 1 | 1 |
| Asset trading | (1) | (1) |
| Other effects (including for new business) | (4) | 3 |
| Total allowance for credit risk at 31 December 2014 | 58 | 46 |

Overall the movement has led to the credit allowance for Pillar 1 purposes to be 41 per cent (2013: 47 per cent) of the bond spread over swap rates. For IFRS purposes it represents 32 per cent (2013: 32 per cent) of the bond spread over swap rates.

The reserves for credit risk allowance at 31 December 2014 for the UK shareholder annuity fund were as follows:

| | Pillar 1 Regulatory basis Total £bn | IFRS Total £bn |
|-------------------------|----------------------------------------------|-------------------|
| PRIL | 2.0 | 1.6 |
| PAC non-profit sub-fund | 0.2 | 0.1 |
| Total 31 December 2014 | 2.2 | 1.7 |
| Total 31 December 2013 | 1.9 | 1.3 |

Other assumption changes

For the shareholder-backed business, the net effect of other assumption changes and modelling adjustments was a credit of £28 million (2013: a credit of £20 million).

B5 Tax charge

(a) Total tax charge by nature of expense

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

| | 2014 £m | | Total | 2013 £m |
|---------------------------|-------------|--------------|-------|---------|
| | Current tax | Deferred tax | | |
| Tax charge | | | | |
| UK tax | (579) | 1 | (578) | (300) |
| Overseas tax | (529) | 169 | (360) | (436) |
| Total tax (charge) credit | (1,108) | 170 | (938) | (736) |

The current tax charge of £1,108 million includes £37 million (2013: £18 million) in respect of the tax charge for the Hong Kong operation. The Hong Kong current tax charge is calculated as 16.5 per cent for all periods on either (i) 5 per cent of the net insurance premium or (ii) the estimated assessable profits, depending on the nature of the business written.

The total tax charge comprises tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders as shown below.

| | 2014 £m | | 2013* £m | |
|-----------------------------------------|-------------|--------------|----------|-------|
| | Current tax | Deferred tax | Total | Total |
| Tax charge | | | | |
| Tax charge to policyholders' returns | (449) | (91) | (540) | (447) |
| Tax charge attributable to shareholders | (659) | 261 | (398) | (289) |
| Total tax (charge) credit | (1,108) | 170 | (938) | (736) |

The principal reason for the increase in the tax charge attributable to policyholders' returns is an increase in current tax in the with profits life fund in the UK insurance operations.

(b) Reconciliation of effective tax rate

Reconciliation of tax charge on profit attributable to shareholders

| | 2014 £m (Except for tax rates) | | | | Total |
|-----------------------------------------------------------------|--------------------------------|-------------------------|-------------------------|------------------|-------|
| | US insurance operations | US insurance operations | UK insurance operations | Other operations | |
| Operating profit (loss) based on longer-term investment returns | 1,050 | 1,431 | 776 | (71) | 3,186 |
| Non-operating profit (loss) | 170 | (1,174) | 545 | (113) | (572) |
| Profit (loss) before tax attributable to shareholders | 1,220 | 257 | 1,321 | (184) | 2,614 |
| Expected tax rate:† | 22% | 35% | 21% | 22% | 23% |
| Tax charge (credit) at the expected tax rate | 268 | 90 | 277 | (41) | 594 |
| Effects of: | | | | | |

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| | | | | | |
|----------------------------------------------------------------------------------------|------------|----------|------------|-------------|------------|
| Adjustment to tax charge in relation to prior years | (2) | (1) | 3 | (7) | (7) |
| Movements in provisions for open tax matters | 7 | - | - | (26) | (19) |
| Income not taxable or taxable at concessionary rates | (17) | (82) | - | (2) | (101) |
| Deductions not allowable for tax purposes | 13 | - | 7 | 9 | 29 |
| Effect of different basis of tax in local jurisdiction | (44) | - | - | - | (44) |
| Impact of changes in local statutory tax rates | (1) | - | 2 | - | 1 |
| Deferred tax adjustments | (8) | - | (7) | (11) | (26) |
| Effect of results of joint ventures and associates | (40) | - | (8) | (10) | (58) |
| Irrecoverable withholding taxes | - | - | - | 27 | 27 |
| Other | (4) | 1 | (3) | 8 | 2 |
| Total actual tax charge (credit) | 172 | 8 | 271 | (53) | 398 |
| Analysed into: | | | | | |
| Tax charge (credit) on operating profit (loss) based on longer-term investment returns | 171 | 419 | 168 | (34) | 724 |
| Tax charge (credit) on non-operating profit (loss) | 1 | (411) | 103 | (19) | (326) |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | 16% | 29% | 22% | 48% | 23% |
| Total profit | 14% | 3% | 21% | 29% | 15% |

† The expected tax rates shown in the table above (rounded to the nearest whole percentage) reflect the corporation tax rates generally applied to taxable profits of the relevant country jurisdictions. For Asia operations the expected tax rates reflect the corporation tax rates weighted by reference to the source of profits of operations contributing to the aggregate business result. The expected tax rate for other operations reflects the mix of business between UK and overseas non-insurance operations, which are taxed at a variety of rates. The rates will fluctuate from year to year dependent on the mix of profit

| | 2013 £m (Except for tax rates) | | | | Total* |
|-----------------------------------------------------------------|--------------------------------|-------------------------|-------------------------|------------------|---------|
| | Asia insurance operations* | US insurance operations | UK insurance operations | Other operations | |
| Operating profit (loss) based on longer-term investment returns | 1,001 | 1,243 | 735 | (25) | 2,954 |
| Non-operating loss | (313) | (690) | (289) | (27) | (1,319) |
| Profit (loss) before tax attributable to shareholders | 688 | 553 | 446 | (52) | 1,635 |
| Expected tax rate:† | 21% | 35% | 23% | 23% | 26% |
| Tax charge (credit) at the expected tax rate | 144 | 194 | 103 | (12) | 429 |
| Effects of: | | | | | |
| Adjustment to tax charge in relation to prior years | (3) | - | 4 | (7) | (6) |
| Movements in provisions for open tax matters | 5 | - | - | (12) | (7) |
| Income not taxable or taxable at concessionary rates | (45) | (88) | - | (10) | (143) |
| Deductions not allowable for tax purposes | 61 | - | - | 5 | 66 |
| Impact of changes in local statutory tax rates | (9) | - | (51) | 5 | (55) |
| Deferred tax adjustments | (4) | - | - | (8) | (12) |

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| | | | | | |
|----------------------------------------------------------------------------------------|------|-------|------|------|-------|
| Effect of results of joint ventures and associates | (10) | - | - | (8) | (18) |
| Irrecoverable withholding taxes | - | - | - | 20 | 20 |
| Other | 9 | (5) | 16 | (5) | 15 |
| Total actual tax charge (credit) | 148 | 101 | 72 | (32) | 289 |
| Analysed into: | | | | | |
| Tax charge (credit) on operating profit (loss) based on longer-term investment returns | 173 | 343 | 132 | (10) | 638 |
| Tax credit on non-operating loss | (25) | (242) | (60) | (22) | (349) |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | 17% | 28% | 18% | 40% | 22% |
| Total profit | 22% | 18% | 16% | 62% | 18% |

† The expected tax rates shown in the table above reflect the corporation tax rates generally applied to taxable profits of the relevant country jurisdictions. For Asia operations the expected tax rates reflect the corporation tax rates weighted by reference to the source of profits of operations contributing to the aggregate business result. The expected tax rate for Other operations reflects the mix of business between UK and overseas non-insurance operations, which are taxed at a variety of rates. The rates will fluctuate from year to year dependent on the mix of profits.

* The expected and actual tax rates as shown includes the impact of the held for sale Japan Life business. For 2014, the tax rates for Asia insurance and Group excluding the impact of the held for sale Japan Life business are the same. For 2013 the tax rates for Asia insurance and Group, excluding the impact of the held for sale Japan Life business are as follows:

| | | |
|----------------------------------------------------------|----------------|-------------|
| Expected tax rate on total profit | Asia insurance | Total Group |
| | 23% | 27% |
| Actual tax rate: | | |
| Operating profit based on longer-term investment returns | 17% | 22% |
| Total profit | 19% | 17% |

B6 Earnings per share

| | Note | 2014 | | | | |
|------------------------------------------------------------------------------|------|------------|-------|------------|--------------------------|----------------------------|
| | | Before tax | Tax | Net of tax | Basic earnings per share | Diluted earnings per share |
| | | £m | £m | £m | Pence | Pence |
| Based on operating profit based on longer-term investment returns | | 3,186 | (724) | 2,462 | 96.6p | 96.5p |
| Short-term fluctuations in investment returns on shareholder-backed business | B1.2 | (574) | 299 | (275) | (10.8)p | (10.8)p |
| Gain on sale of PruHealth and PruProtect | D1 | 86 | - | 86 | 3.4p | 3.4p |
| Amortisation of acquisition accounting adjustments | | (79) | 26 | (53) | (2.1)p | (2.1)p |
| Costs of domestication of Hong Kong branch | D2 | (5) | 1 | (4) | (0.2)p | (0.2)p |
| Based on profit for the year | | 2,614 | (398) | 2,216 | 86.9p | 86.8p |
| | | 2013 | | | | |
| | | Before | Tax | Net of tax | Basic | Diluted |

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| | | tax | | earnings per share | | earnings per share |
|------------------------------------------------------------------------------|------|------------|----------|--------------------|---------|--------------------|
| | Note | B1.1 £m | B5 £m | £m | Pence | Pence |
| Based on operating profit based on longer-term investment returns | | 2,954 | (638) | 2,316 | 90.9p | 90.7p |
| Short-term fluctuations in investment returns on shareholder-backed business | B1.2 | (1,110) | 318 | (792) | (31.1)p | (31.0)p |
| Amortisation of acquisition accounting adjustments | | (72) | 24 | (48) | (1.9)p | (1.9)p |
| Loss attaching to held for sale Japan Life business | D1 | (102) | - | (102) | (4.0)p | (4.0)p |
| Costs of domestication of Hong Kong branch | D2 | (35) | 7 | (28) | (1.1)p | (1.1)p |
| Based on profit for the year | | 1,635 | (289) | 1,346 | 52.8p | 52.7p |

In order to facilitate 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 Japan Life business are included separately within the supplementary analysis of profit as shown above.

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

The weighted average number of shares for calculating earnings per share:

| | 2014 (millions) | 2013 (millions) |
|------------------------------------------------------------------------------------|--------------------|--------------------|
| Weighted average number of shares for calculation of: | | |
| Basic earnings per share | 2,549 | 2,548 |
| Shares under option at end of year | 9 | 10 |
| Number of shares that would have been issued at fair value on assumed option price | (6) | (6) |
| Diluted earnings per share | 2,552 | 2,552 |

B7 Dividends

| | 2014 | | 2013 | |
|------------------------------------------------|-----------------|-----|-----------------|-----|
| | Pence per share | £m | Pence per share | £m |
| Dividends relating to reporting year: | | | | |
| Interim dividend | 11.19p | 287 | 9.73p | 249 |
| Final dividend | 25.74p | 658 | 23.84p | 610 |
| Total | 36.93p | 945 | 33.57p | 859 |
| Dividends declared and paid in reporting year: | | | | |
| Current year interim dividend | 11.19p | 285 | 9.73p | 249 |
| Final dividend for prior year | 23.84p | 610 | 20.79p | 532 |
| Total | 35.03p | 895 | 30.52p | 781 |

Dividend per share

Interim dividends are recorded in the period in which they are paid. Final dividends are recorded in the period in which they are approved by shareholders. The final dividend for the year ended 31 December 2013 of 23.84 pence per ordinary share was paid to eligible shareholders on 22 May 2014 and the 2014 interim dividend of 11.19 pence per

ordinary share was paid to eligible shareholders on 25 September 2014.

The 2014 final dividend of 25.74 pence per ordinary share will be paid on 21 May 2015 in sterling to shareholders on the principal register and the Irish branch register at 6.00pm BST on 27 March 2015 (Record Date), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 29 May 2015. The final dividend will be paid on or about 28 May 2015 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte.) Limited (CDP) at 5.00pm Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 9 March 2015.

The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG\$, will be determined by CDP.

Shareholders on the principal register and Irish branch register will be able to participate in a Dividend Reinvestment Plan.

C BALANCE SHEET

C1 Analysis of Group position by segment and business type

To explain the assets, liabilities and capital of the Group's businesses more comprehensively, it is appropriate to provide analyses of the Group's statement of financial position by operating segment and type of business.

C1.1 Group statement of financial position analysis by segment

| | Note | Insurance operations | | | | 2014 £m | | | | 2013 |
|------------------------|---------|----------------------|------------|------------|----------------------------------|----------------------------------------|--------------------------------------------------|----------------------------------------------------------------------------|--------------------------|--------------------------|
| | | Asia C2.1 | US C2.2 | UK C2.3 | Total insurance operations | Asset manage- ment operations | Unallo- cated (central opera- tions) | Elimin- ation to a of intra- group debtors and creditors | 31 Dec Group Total | 31 Dec Group Total |
| By operating segment | | | | | | | | | | |
| Assets | | | | | | | | | | |
| Intangible assets | | | | | | | | | | |
| attributable to | | | | | | | | | | |
| shareholders: | | | | | | | | | | |
| Goodwill | C5.1(a) | 233 | - | - | 233 | 1,230 | - | - | 1,463 | 1,461 |
| Deferred acquisition | | | | | | | | | | |
| costs and other | | | | | | | | | | |
| intangible assets | C5.1(b) | 1,911 | 5,197 | 86 | 7,194 | 21 | 46 | - | 7,261 | 5,295 |
| Total | | 2,144 | 5,197 | 86 | 7,427 | 1,251 | 46 | - | 8,724 | 6,756 |
| Intangible assets | | | | | | | | | | |
| attributable to | | | | | | | | | | |
| with-profits funds: | | | | | | | | | | |
| Goodwill in respect of | | - | - | 186 | 186 | - | - | - | 186 | 177 |
| acquired subsidiaries | | | | | | | | | | |

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| | | | | | | | | | | |
|------------------------------------------------------------------------------------|-------|--------|---------|---------|---------|-------|-------|----------|---------|---------|
| for venture fund and other investment purposes | | | | | | | | | | |
| Deferred acquisition costs and other intangible assets | | 54 | - | 7 | 61 | - | - | - | 61 | 72 |
| Total | | 54 | - | 193 | 247 | - | - | - | 247 | 249 |
| Total | | 2,198 | 5,197 | 279 | 7,674 | 1,251 | 46 | - | 8,971 | 7,005 |
| Deferred tax assets | C8 | 84 | 2,343 | 132 | 2,559 | 141 | 65 | - | 2,765 | 2,412 |
| Other non-investment and non-cash assets | | 3,111 | 6,617 | 6,826 | 16,554 | 1,464 | 5,058 | (10,295) | 12,781 | 12,357 |
| Investments of long-term business and other operations: | | | | | | | | | | |
| Investment properties | | - | 28 | 12,736 | 12,764 | - | - | - | 12,764 | 11,477 |
| Investments in joint ventures and associates accounted for using the equity method | | 374 | - | 536 | 910 | 107 | - | - | 1,017 | 809 |
| Financial investments: | | | | | | | | | | |
| Loans | C3.4 | 1,014 | 6,719 | 4,254 | 11,987 | 854 | - | - | 12,841 | 12,566 |
| Equity securities and portfolio holdings in unit trusts | | 19,200 | 82,081 | 43,468 | 144,749 | 79 | 34 | - | 144,862 | 120,222 |
| Debt securities | C3.3 | 23,629 | 32,980 | 86,349 | 142,958 | 2,293 | - | - | 145,251 | 132,905 |
| Other investments | | 48 | 1,670 | 5,782 | 7,500 | 121 | 2 | - | 7,623 | 6,265 |
| Deposits | | 769 | - | 12,253 | 13,022 | 74 | - | - | 13,096 | 12,213 |
| Total investments | | 45,034 | 123,478 | 165,378 | 333,890 | 3,528 | 36 | - | 337,454 | 296,457 |
| Assets held for sale | D1(b) | 819 | - | 5 | 824 | - | - | - | 824 | 916 |
| Cash and cash equivalents | | 1,684 | 904 | 2,457 | 5,045 | 1,044 | 320 | - | 6,409 | 6,785 |
| Total assets | C3.1 | 52,930 | 138,539 | 175,077 | 366,546 | 7,428 | 5,525 | (10,295) | 369,204 | 325,932 |

| | | | | | | 2014 £m | | 2013 £m | | |
|---------------------------|------|----------------------|-------|-------|------------|----------------------------|-------------------------------------------------------|-----------------------------------------------------|--------------------|--------------------|
| | | Insurance operations | | | | | | | | |
| | | | | | | Total insurance operations | Unallo- Asset segment management (central operations) | Elimin- ation of intra- group debtors and creditors | 31 Dec Group Total | 31 Dec Group Total |
| By operating segment | Note | Asia | US | UK | operations | operations | | | | |
| Equity and liabilities | | | | | | | | | | |
| Equity | | | | | | | | | | |
| Shareholders' equity | | 3,548 | 4,067 | 3,804 | 11,419 | 2,077 | (1,685) | - | 11,811 | 9,650 |
| Non-controlling interests | | 1 | - | - | 1 | - | - | - | 1 | 1 |
| Total equity | | 3,549 | 4,067 | 3,804 | 11,420 | 2,077 | (1,685) | - | 11,812 | 9,651 |

Liabilities

Policyholder liabilities and unallocated surplus of with-profits funds:

| | | | | | | | | | | |
|--------------------------------------------------------------------------------------------|------|--------|---------|---------|---------|-------|-------|---------|---------|---------|
| Insurance contract liabilities | | 39,670 | 124,076 | 87,655 | 251,401 | - | - | (1,363) | 250,038 | 218,185 |
| Investment contract liabilities with discretionary participation features | | 218 | - | 39,059 | 39,277 | - | - | - | 39,277 | 35,592 |
| Investment contract liabilities without discretionary participation features | | 180 | 2,670 | 17,374 | 20,224 | - | - | - | 20,224 | 20,176 |
| Unallocated surplus of with-profits funds | | 2,102 | - | 10,348 | 12,450 | - | - | - | 12,450 | 12,061 |
| Total policyholder liabilities and unallocated surplus of with-profits funds | C4 | 42,170 | 126,746 | 154,436 | 323,352 | - | - | (1,363) | 321,989 | 286,014 |
| Core structural borrowings of shareholder-financed operations: | | | | | | | | | | |
| Subordinated debt | | - | - | - | - | - | 3,320 | - | 3,320 | 3,662 |
| Other | | - | 160 | - | 160 | 275 | 549 | - | 984 | 974 |
| Total | C6.1 | - | 160 | - | 160 | 275 | 3,869 | - | 4,304 | 4,636 |
| Operational borrowings attributable to shareholder-financed operations | C6.2 | - | 179 | 74 | 253 | 6 | 2,004 | - | 2,263 | 2,152 |
| Borrowings attributable to with-profits operations | C6.2 | - | - | 1,093 | 1,093 | - | - | - | 1,093 | 895 |
| Other non-insurance liabilities: | | | | | | | | | | |
| Obligations under funding, securities lending and sale and repurchase agreements | | - | 1,156 | 1,191 | 2,347 | - | - | - | 2,347 | 2,074 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | | 2,161 | 22 | 5,174 | 7,357 | - | - | - | 7,357 | 5,278 |
| Deferred tax liabilities | C8.1 | 719 | 2,308 | 1,228 | 4,255 | 22 | 14 | - | 4,291 | 3,778 |
| Current tax liabilities | C8.2 | 65 | 1 | 414 | 480 | 66 | 71 | - | 617 | 395 |
| Accruals and deferred income | | 123 | - | 441 | 564 | 328 | 55 | - | 947 | 824 |
| Other creditors | | 2,434 | 776 | 5,159 | 8,369 | 4,054 | 771 | (8,932) | 4,262 | 3,307 |
| Provisions | | 110 | 5 | 202 | 317 | 335 | 72 | - | 724 | 635 |

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| | | | | | | | | | | |
|------------------------------|-------|--------|---------|---------|---------|-------|-------|----------|---------|---------|
| Derivative liabilities | | 143 | 251 | 1,381 | 1,775 | 233 | 315 | - | 2,323 | 1,689 |
| Other liabilities | | 686 | 2,868 | 480 | 4,034 | 32 | 39 | - | 4,105 | 3,736 |
| Total | | 6,441 | 7,387 | 15,670 | 29,498 | 5,070 | 1,337 | (8,932) | 26,973 | 21,716 |
| Liabilities held for sale | D1(b) | 770 | - | - | 770 | - | - | - | 770 | 868 |
| Total liabilities | C3.1 | 49,381 | 134,472 | 171,273 | 355,126 | 5,351 | 7,210 | (10,295) | 357,392 | 316,281 |
| Total equity and liabilities | | 52,930 | 138,539 | 175,077 | 366,546 | 7,428 | 5,525 | (10,295) | 369,204 | 325,932 |

C1.2 Group statement of financial position - analysis by business type

| | Note | 31 Dec 2014 £m | | | | | | 31 Dec 2013 £m | |
|------------------------------------------------------------------------------------|---------|---------------------|-------------------------------------------|---------------------|-----------------------------|-----------------------------------------------|---------------------------------------------------|----------------|-------------|
| | | Policyholder | Shareholder-backed business | | | Unallocated to a segment (central operations) | Eliminations of Intra-group debtors and creditors | Group Total | Group Total |
| | | Participating funds | Unit-linked and variable annuity business | Non-linked business | Asset management operations | | | | |
| Assets | | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | | |
| Goodwill | C5.1(a) | - | - | 233 | 1,230 | - | - | 1,463 | 1,461 |
| Deferred acquisition costs and other intangible assets | C5.1(b) | - | - | 7,194 | 21 | 46 | - | 7,261 | 5,295 |
| Total | | - | - | 7,427 | 1,251 | 46 | - | 8,724 | 6,756 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | | | | | | | | | |
| | | 186 | - | - | - | - | - | 186 | 177 |
| Deferred acquisition costs and other intangible assets | | 61 | - | - | - | - | - | 61 | 72 |
| Total | | 247 | - | - | - | - | - | 247 | 249 |
| Total | | 247 | - | 7,427 | 1,251 | 46 | - | 8,971 | 7,005 |
| Deferred tax assets | C8 | 71 | - | 2,488 | 141 | 65 | - | 2,765 | 2,412 |
| Other non-investment and non-cash assets | | 2,943 | 635 | 10,135 | 1,464 | 5,058 | (7,454) | 12,781 | 12,357 |
| Investments of long-term business and other operations: | | | | | | | | | |
| Investment properties | | 10,371 | 694 | 1,699 | - | - | - | 12,764 | 11,477 |
| Investments in joint ventures and associates accounted for using the equity method | | 536 | - | 374 | 107 | - | - | 1,017 | 809 |
| Financial investments: | | | | | | | | | |
| Loans | C3.4 | 3,209 | - | 8,778 | 854 | - | - | 12,841 | 12,566 |
| Equity securities and portfolio holdings in unit trusts | | 34,662 | 108,749 | 1,338 | 79 | 34 | - | 144,862 | 120,222 |

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| | | | | | | | | | |
|------------------------------------------------------------------------------------------------------------------|---------|---------|---------|---------|-------|---------|---------|---------|---------|
| Debt securities | C3.3 | 59,573 | 10,895 | 72,490 | 2,293 | - | - | 145,251 | 132,905 |
| Other investments | | 5,345 | 33 | 2,122 | 121 | 2 | - | 7,623 | 6,265 |
| Deposits | | 10,444 | 938 | 1,640 | 74 | - | - | 13,096 | 12,213 |
| Total investments | | 124,140 | 121,309 | 88,441 | 3,528 | 36 | - | 337,454 | 296,457 |
| Assets held for sale | D1(b) | - | 286 | 538 | - | - | - | 824 | 916 |
| Cash and cash equivalents | | 1,967 | 863 | 2,215 | 1,044 | 320 | - | 6,409 | 6,785 |
| Total assets | | 129,368 | 123,093 | 111,244 | 7,428 | 5,525 | (7,454) | 369,204 | 325,932 |
| Equity and liabilities | | | | | | | | | |
| Equity | | | | | | | | | |
| Shareholders' equity | | - | - | 11,419 | 2,077 | (1,685) | - | 11,811 | 9,650 |
| Non-controlling interests | | - | - | 1 | - | - | - | 1 | 1 |
| Total equity | | - | - | 11,420 | 2,077 | (1,685) | - | 11,812 | 9,651 |
| Liabilities | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | | | | | | | | | |
| | | 105,589 | 118,915 | 85,035 | - | - | - | 309,539 | 273,953 |
| Unallocated surplus of with-profits funds | | | | | | | | | |
| | | 12,450 | - | - | - | - | - | 12,450 | 12,061 |
| Total policyholder liabilities and unallocated surplus of with-profits funds | | | | | | | | | |
| | C4.1(a) | 118,039 | 118,915 | 85,035 | - | - | - | 321,989 | 286,014 |
| Core structural borrowings of shareholder-financed operations: | | | | | | | | | |
| Subordinated debt | | | | | | | | | |
| | | - | - | - | - | 3,320 | - | 3,320 | 3,662 |
| Other | | | | | | | | | |
| | | - | - | 160 | 275 | 549 | - | 984 | 974 |
| Total | C6.1 | - | - | 160 | 275 | 3,869 | - | 4,304 | 4,636 |
| Operational borrowings attributable to shareholder-financed operations | | | | | | | | | |
| | C6.2 | - | 4 | 249 | 6 | 2,004 | - | 2,263 | 2,152 |
| Borrowings attributable to with-profits operations | | | | | | | | | |
| | C6.2 | 1,093 | - | - | - | - | - | 1,093 | 895 |
| Deferred tax liabilities | C8 | 1,307 | 38 | 2,910 | 22 | 14 | - | 4,291 | 3,778 |
| Other non-insurance liabilities | | 8,929 | 3,855 | 10,981 | 5,048 | 1,323 | (7,454) | 22,682 | 17,938 |
| Liabilities held for sale | D1(b) | - | 281 | 489 | - | - | - | 770 | 868 |
| Total liabilities | | 129,368 | 123,093 | 99,824 | 5,351 | 7,210 | (7,454) | 357,392 | 316,281 |
| Total equity and liabilities | | 129,368 | 123,093 | 111,244 | 7,428 | 5,525 | (7,454) | 369,204 | 325,932 |

C2 Analysis of segment position by business type

To show the statement of financial position by reference to the differing degrees of policyholder and shareholder economic interest of the different types of business, the analysis below is structured to show separately assets and liabilities of each segment by business type.

C2.1 Asia insurance operations

| | 31 Dec 2014 £m | | | 31 Dec 2013 £m | |
|------------------------------------------------------------------------------------------------------------------|--------------------------------------|------------------------------------------|-------------------|-------------------|--------|
| | With-profits business note (i) | Unit-linked assets and liabilities | Other business | Total | Total |
| Assets | | | | | |
| Intangible assets attributable to shareholders: | | | | | |
| Goodwill | - | - | 233 | 233 | 231 |
| Deferred acquisition costs and other intangible assets | - | - | 1,911 | 1,911 | 1,026 |
| Total | - | - | 2,144 | 2,144 | 1,257 |
| Intangible assets attributable to with-profits funds: | | | | | |
| Deferred acquisition costs and other intangible assets | 54 | - | - | 54 | 66 |
| Deferred tax assets | - | - | 84 | 84 | 55 |
| Other non-investment and non-cash assets | 1,943 | 168 | 1,000 | 3,111 | 1,073 |
| Investments of long-term business and other operations: | | | | | |
| Investment properties | - | - | - | - | 1 |
| Investments in joint ventures and associates accounted for using the equity method | - | - | 374 | 374 | 268 |
| Financial investments: | | | | | |
| Loans C3.4 | 544 | - | 470 | 1,014 | 922 |
| Equity securities and portfolio holdings in unit trusts | 6,974 | 11,294 | 932 | 19,200 | 14,383 |
| Debt securities C3.3 | 12,927 | 2,847 | 7,855 | 23,629 | 18,554 |
| Other investments | 18 | 20 | 10 | 48 | 41 |
| Deposits | 190 | 243 | 336 | 769 | 896 |
| Total investments | 20,653 | 14,404 | 9,977 | 45,034 | 35,065 |
| Assets held for sale | - | 281 | 538 | 819 | 916 |
| Cash and cash equivalents | 547 | 329 | 808 | 1,684 | 1,522 |
| Total assets | 23,197 | 15,182 | 14,551 | 52,930 | 39,954 |
| Equity and liabilities | | | | | |
| Equity | | | | | |
| Shareholders' equity | - | - | 3,548 | 3,548 | 2,795 |
| Non-controlling interests | - | - | 1 | 1 | 1 |
| Total equity | - | - | 3,549 | 3,549 | 2,796 |
| Liabilities | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | 17,873 | 13,874 | 8,321 | 40,068 | 31,910 |
| Unallocated surplus of with-profits funds note (ii) | 2,102 | - | - | 2,102 | 77 |
| Total C4.1(b) | 19,975 | 13,874 | 8,321 | 42,170 | 31,987 |
| Deferred tax liabilities | 458 | 38 | 223 | 719 | 594 |
| Other non-insurance liabilities | 2,764 | 989 | 1,969 | 5,722 | 3,709 |
| Liabilities held for sale | - | 281 | 489 | 770 | 868 |
| Total liabilities | 23,197 | 15,182 | 11,002 | 49,381 | 37,158 |

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Total equity and liabilities 23,197 15,182 14,551 52,930 39,954

Notes

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

(ii) On 1 January 2014, the Hong Kong branch of PAC was transferred to separate subsidiaries established in Hong Kong. From this date, the unallocated surplus of the Hong Kong with-profits business is reported within the Asia insurance segment. Up until 31 December 2013, for the purpose of the presentation of unallocated surplus of with-profits within the statement of financial position, the Hong Kong branch balance was reported within the unallocated surplus of the PAC with-profits sub-fund of the UK insurance operations.

C2.2 US insurance operations

| | 31 Dec 2014 £m | | | 31 Dec 2013 £m | |
|---------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|---------------------------------------------------------------|---------|-------------------|---------|
| | Variable annuity separate account assets and liabilities note (i) | Fixed annuity, GIC and other business note (i) | Total | Total | Total |
| Assets | | | | | |
| Intangible assets attributable to shareholders: | | | | | |
| Deferred acquisition costs and other intangibles | - | 5,197 | 5,197 | 4,140 | 4,140 |
| Total | - | 5,197 | 5,197 | 4,140 | 4,140 |
| Deferred tax assets | - | 2,343 | 2,343 | 2,042 | 2,042 |
| Other non-investment and non-cash assets note (iv) | - | 6,617 | 6,617 | 6,710 | 6,710 |
| Investment properties | - | 28 | 28 | 28 | 28 |
| Financial investments: | | | | | |
| Loans C3.4 | - | 6,719 | 6,719 | 6,375 | 6,375 |
| Equity securities and portfolio holdings in unit trusts note (iii) | 81,741 | 340 | 82,081 | 66,008 | 66,008 |
| Debt securities C3.3 | - | 32,980 | 32,980 | 30,292 | 30,292 |
| Other investments note (ii) | - | 1,670 | 1,670 | 1,557 | 1,557 |
| Total investments | 81,741 | 41,737 | 123,478 | 104,260 | 104,260 |
| Cash and cash equivalents | - | 904 | 904 | 604 | 604 |
| Total assets | 81,741 | 56,798 | 138,539 | 117,756 | 117,756 |
| Equity and liabilities | | | | | |
| Equity | | | | | |
| Shareholders' equity note (vi) | - | 4,067 | 4,067 | 3,446 | 3,446 |
| Total equity | - | 4,067 | 4,067 | 3,446 | 3,446 |
| Liabilities | | | | | |
| Policyholder liabilities: | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) note (v) | 81,741 | 45,005 | 126,746 | 107,411 | 107,411 |
| Total C4.1 (c) | 81,741 | 45,005 | 126,746 | 107,411 | 107,411 |
| Core structural borrowings of shareholder-financed operations | - | 160 | 160 | 150 | 150 |
| | - | 179 | 179 | 142 | 142 |

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Operational borrowings attributable to shareholder-financed operations

| | | | | |
|------------------------------------------|--------|--------|---------|---------|
| Deferred tax liabilities | - | 2,308 | 2,308 | 1,948 |
| Other non-insurance liabilities note (v) | - | 5,079 | 5,079 | 4,659 |
| Total liabilities | 81,741 | 52,731 | 134,472 | 114,310 |
| Total equity and liabilities | 81,741 | 56,798 | 138,539 | 117,756 |

Notes

(i) These amounts are for separate account assets and liabilities for all variable annuity products comprising those with and without guarantees. Assets and liabilities attaching to variable annuity business that are not held in the separate account e.g. in respect of guarantees are shown within other business.

(ii) Other investments comprise:

| | 2014 | 2013 |
|----------------------------------------------|-------|-------|
| | £m | £m |
| Derivative assets* | 916 | 766 |
| Partnerships in investment pools and other** | 754 | 791 |
| | 1,670 | 1,557 |

* After taking account of the derivative liabilities of £251 million (2013: £515 million), which are also included in other non-insurance liabilities, the derivative position for US operations is a net asset of £665 million (2013: £251 million).

** Partnerships in investment pools and other comprise primarily investments in limited partnerships. These include interests in the PPM America Private Equity Fund and diversified investments in 164 (2013: 166) other partnerships by independent money managers that generally invest in various equities and fixed income loans and securities.

(iii) Equity securities and portfolio holdings in unit trusts include investments in mutual funds, the majority of which are equity-based.

(iv) Included within other non-investment and non-cash assets of £6,617 million (2013: £6,710 million) were balances of £5,979 million (2013: £6,065 million) for reinsurers' share of insurance contract liabilities. Of the £5,979 million as at 31 December 2014, £5,174 million related to the reinsurance ceded by the REALIC business (2013: £5,410 million). Jackson holds collateral for certain of these reinsurance arrangements with a corresponding funds withheld liability. As of 31 December 2014, the funds withheld liability of £2,201 million (2013: £2,051 million) was recorded within other non-insurance liabilities.

(v) In addition to the policyholder liabilities above, Jackson has entered into a programme of funding arrangements under contracts, which, in substance are almost identical to GICs. The liabilities under these funding agreements totalled, £844 million (2013: £485 million) and are included in other non-insurance liabilities in the statement of financial position above.

(vi) Changes in shareholders' equity:

| | 2014 | 2013 |
|----------------------------------------------------------------------------------------|---------|-------|
| | £m | £m |
| Operating profit based on longer-term investment returns B1.1 | 1,431 | 1,243 |
| Short-term fluctuations in investment returns B1.2 | (1,103) | (625) |
| Amortisation of acquisition accounting adjustments arising from the purchase of REALIC | (71) | (65) |
| Profit before shareholder tax | 257 | 553 |
| Tax B5 | (8) | (101) |
| Profit for the year | 249 | 452 |

| | 2014 | 2013 |
|--|------|------|
| | £m | £m |

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| | | |
|--------------------------------------------------------------------------------|-------|---------|
| Profit for the year (as above) | 249 | 452 |
| Items recognised in other comprehensive income: | | |
| Exchange movements | 235 | (32) |
| Unrealised valuation movements on securities classified as available-for sale: | | |
| Unrealised holding gains (losses) arising during the year | 1,039 | (2,025) |
| Deduct net gains included in the income statement | (83) | (64) |
| Total unrealised valuation movements | 956 | (2,089) |
| Related amortisation of deferred acquisition costs | | |
| C5.1(b) | (87) | 498 |
| Related tax | (304) | 557 |
| Total other comprehensive income (loss) | 800 | (1,066) |
| Total comprehensive income (loss) for the year | 1,049 | (614) |
| Dividends, interest payments to central companies and other movements | (428) | (283) |
| Net increase (decrease) in equity | 621 | (897) |
| Shareholders' equity at beginning of year | 3,446 | 4,343 |
| Shareholders' equity at end of year | 4,067 | 3,446 |

C2.3 UK insurance operations

Of the total investments of £165 billion in UK insurance operations, £103 billion of investments are held by Scottish Amicable Insurance Fund and the PAC with-profits sub-fund. Shareholders are exposed only indirectly to value movements on these assets.

| | 31 Dec 2014 £m | | | | | 31 Dec 2013 £m | |
|------------------------------------------------------------------------------------|----------------------------------|---------------------------|------------------------------------|--------------------------------------|-------|----------------|-------|
| | Other funds and subsidiaries | | | | | | |
| | Scottish Amicable Insurance Fund | PAC with-profits sub-fund | Unit-linked assets and liabilities | Annuity and other long-term business | Total | Total | Total |
| | note (ii) | notes (i) | | | | | |
| By operating segment | | | | | | | |
| Assets | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | |
| Deferred acquisition costs and other intangible assets | - | - | - | 86 | 86 | 86 | 90 |
| Total | - | - | - | 86 | 86 | 86 | 90 |
| Intangible assets attributable to with-profits funds: | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | - | 186 | - | - | - | 186 | 177 |
| Deferred acquisition costs | - | 7 | - | - | - | 7 | 6 |
| Total | - | 193 | - | - | - | 193 | 183 |
| Total | - | 193 | - | 86 | 86 | 279 | 273 |
| Deferred tax assets | - | 71 | - | 61 | 61 | 132 | 142 |
| Other non-investment and non-cash assets | 208 | 3,633 | 467 | 2,518 | 2,985 | 6,826 | 5,808 |

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Investments of long-term business and other operations:

| | | | | | | | |
|------------------------------------------------------------------------------------|-------|---------|--------|--------|--------|---------|---------|
| Investment properties | 390 | 9,981 | 694 | 1,671 | 2,365 | 12,736 | 11,448 |
| Investments in joint ventures and associates accounted for using the equity method | - | 536 | - | - | - | 536 | 449 |
| Financial investments: | | | | | | | |
| Loans C3.4 | 66 | 2,599 | - | 1,589 | 1,589 | 4,254 | 4,173 |
| Equity securities and portfolio holdings in unit trusts | 2,508 | 25,180 | 15,714 | 66 | 15,780 | 43,468 | 39,745 |
| Debt securities C3.3 | 2,709 | 43,937 | 8,048 | 31,655 | 39,703 | 86,349 | 82,014 |
| Other investmentsnote (iii) | 283 | 5,044 | 13 | 442 | 455 | 5,782 | 4,603 |
| Deposits | 728 | 9,526 | 695 | 1,304 | 1,999 | 12,253 | 11,252 |
| Total investments | 6,684 | 96,803 | 25,164 | 36,727 | 61,891 | 165,378 | 153,684 |
| Properties held for sale | - | - | 5 | - | 5 | 5 | - |
| Cash and cash equivalents | 84 | 1,336 | 534 | 503 | 1,037 | 2,457 | 2,586 |
| Total assets | 6,976 | 102,036 | 26,170 | 39,895 | 66,065 | 175,077 | 162,493 |

31 Dec
2013
£m

31 Dec 2014 £m

Other funds and subsidiaries

| | Scottish Amicable Insurance Fund note (ii) | PAC with-profits sub-fund notes (i) | Unit-linked assets and liabilities | Annuity and other long-term business | Total | Total | Total |
|------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------------------------------|------------------------------------|--------------------------------------|--------|---------|---------|
| Equity and liabilities | | | | | | | |
| Equity | | | | | | | |
| Shareholders' equity | - | - | - | 3,804 | 3,804 | 3,804 | 2,998 |
| Total equity | - | - | - | 3,804 | 3,804 | 3,804 | 2,998 |
| Liabilities | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | 6,690 | 82,389 | 23,300 | 31,709 | 55,009 | 144,088 | 134,632 |
| Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds) C4.1(d) | - | 10,348 | - | - | - | 10,348 | 11,984 |
| Total | 6,690 | 92,737 | 23,300 | 31,709 | 55,009 | 154,436 | 146,616 |

| | | | | | | | |
|------------------------------------------------------------------------|-------|---------|--------|--------|--------|---------|---------|
| Operational borrowings attributable to shareholder-financed operations | - | - | 4 | 70 | 74 | 74 | 74 |
| Borrowings attributable to with-profits funds | 11 | 1,082 | - | - | - | 1,093 | 895 |
| Deferred tax liabilities | 45 | 804 | - | 379 | 379 | 1,228 | 1,213 |
| Other non-insurance liabilities | 230 | 7,413 | 2,866 | 3,933 | 6,799 | 14,442 | 10,697 |
| Total liabilities | 6,976 | 102,036 | 26,170 | 36,091 | 62,261 | 171,273 | 159,495 |
| Total equity and liabilities | 6,976 | 102,036 | 26,170 | 39,895 | 66,065 | 175,077 | 162,493 |

Notes

(i) The PAC with-profits sub-fund (WPSF) mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). Included in the PAC with-profits fund is £11.7 billion (2013: £12.2 billion) of non-profits annuities liabilities. The WPSF's profits are apportioned 90 per cent to its policyholders and 10 per cent to shareholders as surplus for distribution is determined via the annual actuarial valuation. For the purposes of this table and subsequent explanation, references to the WPSF also include, for convenience, the amounts attaching to the Defined Charges Participating Sub-fund which comprises 3.8 per cent of the total assets of the WPSF and includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 1 December 2007 (with assets of approximately £1.7 billion). Profits to shareholders on this with-profits annuity business emerge on a 'charges less expenses' basis and policyholders are entitled to 100 per cent of the investment earnings.

(ii) The fund is solely for the benefit of policyholders of SAIF. Shareholders have no interest in the profits of this fund although they are entitled to asset management fees on this business. SAIF is a separate sub-fund within the PAC long-term business fund.

(iii) Other investments comprise:

| | 2014 £m | 2013 £m |
|----------------------------------------------|---------|---------|
| Derivative assets* | 2,344 | 1,472 |
| Partnerships in investment pools and other** | 3,438 | 3,131 |
| | 5,782 | 4,603 |

* After including derivative liabilities of £1,381 million (2013: £804 million), which are also included in the statement of financial position, the overall derivative position was a net asset of £963 million (2013: £668 million).

** Partnerships in investment pools and other comprise mainly investments held by the PAC with-profits fund. These investments are primarily investments in limited partnerships and additionally, investments in property funds.

C2.4 Asset management operations

| | 31 Dec 2014 £m | | | 31 Dec 2013 £m | |
|--------------------------------------------------------|-----------------|-------------------|---------------------|----------------|-------|
| | M&G note (i) | US Investments | Eastspring Total | Total | Total |
| Assets | | | | | |
| Intangible assets: | | | | | |
| Goodwill | 1,153 | 16 | 61 | 1,230 | 1,230 |
| Deferred acquisition costs and other intangible assets | 18 | 2 | 1 | 21 | 20 |
| Total | 1,171 | 18 | 62 | 1,251 | 1,250 |
| Other non-investment and non-cash assets | 1,308 | 228 | 69 | 1,605 | 1,475 |
| | 35 | - | 72 | 107 | 92 |

Investments in joint ventures and associates accounted for using the equity method

Financial investments:

| | | | | | |
|---------------------------------------------------------------------------------|-------|-----|-----|-------|-------|
| LoansC3.4 | 854 | - | - | 854 | 1,096 |
| Equity securities and portfolio holdings in unit trusts | 61 | - | 18 | 79 | 65 |
| Debt securitiesC3.3 | 2,293 | - | - | 2,293 | 2,045 |
| Other investments | 109 | 12 | - | 121 | 61 |
| Deposits | - | 40 | 34 | 74 | 65 |
| Total investments | 3,352 | 52 | 124 | 3,528 | 3,424 |
| Cash and cash equivalents | 857 | 76 | 111 | 1,044 | 1,562 |
| Total assets | 6,688 | 374 | 366 | 7,428 | 7,711 |
| Equity and liabilities | | | | | |
| Equity | | | | | |
| Shareholders' equity | 1,646 | 157 | 274 | 2,077 | 1,991 |
| Total equity | 1,646 | 157 | 274 | 2,077 | 1,991 |
| Liabilities | | | | | |
| Core structural borrowing of shareholder-financed operations | 275 | - | - | 275 | 275 |
| Operational borrowings attributable to shareholder-financed operations | 6 | - | - | 6 | - |
| Intra-group debt represented by operational borrowings at Group level note (ii) | 2,004 | - | - | 2,004 | 1,933 |
| Other non-insurance liabilitiesnote (iii) | 2,757 | 217 | 92 | 3,066 | 3,512 |
| Total liabilities | 5,042 | 217 | 92 | 5,351 | 5,720 |
| Total equity and liabilities | 6,688 | 374 | 366 | 7,428 | 7,711 |

Notes

- (i) The M&G statement of financial position includes the assets and liabilities in respect of Prudential Capital.
(ii) Intra-group debt represented by operational borrowings at Group level, which are in respect of Prudential Capital's short-term fixed income security programme and comprise:

| | 2014 £m | 2013 £m |
|-----------------------------------------------------------------------------|---------|---------|
| Commercial paper | 1,704 | 1,634 |
| Medium Term Notes | 300 | 299 |
| Total intra-group debt represented by operational borrowings at Group level | 2,004 | 1,933 |

- (iii) Other non-insurance liabilities consist primarily of intra-group balances, derivative liabilities and other creditors.

C3 Assets and Liabilities - Classification and Measurement

C3.1 Group assets and liabilities - Classification

The classification of the Group's assets and liabilities, and its corresponding accounting carrying values reflect the requirements of IFRS. For financial investments the basis of valuation reflects the Group's application of IAS 39 'Financial Instruments: Recognition and Measurement' as described further below. Where assets and liabilities have been valued at fair value or measured on a different basis but fair value is disclosed, the Group has followed the principles under IFRS 13 'Fair Value Measurement'. The basis applied is summarised below:

| 31 December 2014 £m | | | | 31 December 2013 £m | | | |
|---------------------|-----------|----------|--------|---------------------|-----------|----------|--------|
| At fair value | Cost/ | Total | Fair | At fair value | Cost/ | Total | Fair |
| | Amortised | carrying | value, | | Amortised | carrying | value, |

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| | Through profit or loss Available-for-sale | | cost/ IFRS 4 basis value note (i) | value where applicable | Through profit and loss Available-for-sale | | cost/ IFRS 4 basis value note (i) | value where applicable |
|------------------------------------------------------------------------------------|-------------------------------------------|---|-----------------------------------------------|------------------------|--------------------------------------------|---|-----------------------------------------------|------------------------|
| Intangible assets attributable to shareholders: | | | | | | | | |
| Goodwill | - | - | 1,463 | 1,463 | - | - | 1,461 | 1,461 |
| Deferred acquisition costs and other intangible assets | - | - | 7,261 | 7,261 | - | - | 5,295 | 5,295 |
| Total | - | - | 8,724 | 8,724 | - | - | 6,756 | 6,756 |
| Intangible assets attributable to with-profits funds: | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | - | - | 186 | 186 | - | - | 177 | 177 |
| Deferred acquisition costs and other intangible assets | - | - | 61 | 61 | - | - | 72 | 72 |
| Total | - | - | 247 | 247 | - | - | 249 | 249 |
| Total intangible assets | - | - | 8,971 | 8,971 | - | - | 7,005 | 7,005 |
| Other non-investment and non-cash assets: | | | | | | | | |
| Property, plant and | - | - | 978 | 978 | - | - | 920 | 920 |

| | | | | | | | | | | | |
|------------------------------------------------------------------|---------|--------|--------|---------|---------|---------|--------|--------|---------|---------|--|
| equipment | | | | | | | | | | | |
| Reinsurers' share of insurance contract liabilities | - | - | 7,167 | 7,167 | | - | - | 6,838 | 6,838 | | |
| Deferred tax assets | - | - | 2,765 | 2,765 | | - | - | 2,412 | 2,412 | | |
| Current tax recoverable | - | - | 117 | 117 | | - | - | 244 | 244 | | |
| Accrued investment income | - | - | 2,667 | 2,667 | 2,667 | - | - | 2,609 | 2,609 | 2,609 | |
| Other debtors | - | - | 1,852 | 1,852 | 1,852 | - | - | 1,746 | 1,746 | 1,746 | |
| Total | - | - | 15,546 | 15,546 | | - | - | 14,769 | 14,769 | | |
| Investments of long-term business and other operations:note (ii) | | | | | | | | | | | |
| Investment properties | 12,764 | - | - | 12,764 | 12,764 | 11,477 | - | - | 11,477 | 11,477 | |
| Investments accounted for using the equity method | - | - | 1,017 | 1,017 | | - | - | 809 | 809 | | |
| Loans | 2,291 | - | 10,550 | 12,841 | 13,548 | 2,137 | - | 10,429 | 12,566 | 12,566 | |
| Equity securities and portfolio holdings in unit trusts | 144,862 | - | - | 144,862 | 144,862 | 120,222 | - | - | 120,222 | 120,222 | |
| Debt securities | 112,354 | 32,897 | - | 145,251 | 145,251 | 102,700 | 30,205 | - | 132,905 | 132,905 | |
| Other investments | 7,623 | - | - | 7,623 | 7,623 | 6,265 | - | - | 6,265 | 6,265 | |
| Deposits | - | - | 13,096 | 13,096 | 13,096 | - | - | 12,213 | 12,213 | 12,213 | |
| Total investments | 279,894 | 32,897 | 24,663 | 337,454 | | 242,801 | 30,205 | 23,451 | 296,457 | | |
| Assets held for sale | 824 | - | - | 824 | 824 | 916 | - | - | 916 | 916 | |
| Cash and cash equivalents | - | - | 6,409 | 6,409 | 6,409 | - | - | 6,785 | 6,785 | 6,785 | |
| Total assets | 280,718 | 32,897 | 55,589 | 369,204 | | 243,717 | 30,205 | 52,010 | 325,932 | | |

2014 £m

2013 £m

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| | At fair value | | Cost/ Amortised cost/ IFRS 4 basis value note (i) | Total carrying value | Fair value, where applicable | At fair value | | Cost/ Amortised cost/ IFRS 4 basis value note (i) | Total carrying value |
|--------------------------------------------------------------------------------------|-------------------------------|--------------------|---------------------------------------------------------------------|----------------------------|---------------------------------------|-------------------------------|--------------------|---------------------------------------------------------------------|----------------------------|
| | Through profit and loss | Available-for-sale | | | | Through profit and loss | Available-for-sale | | |
| Liabilities | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | |
| Insurance contract liabilities | - | - | 250,038 | 250,038 | | - | - | 218,185 | 218,185 |
| Investment contract liabilities with discretionary participation features note (iii) | - | - | 39,277 | 39,277 | | - | - | 35,592 | 35,592 |
| Investment contract liabilities without discretionary participation features | 17,554 | - | 2,670 | 20,224 | 20,211 | 17,736 | - | 2,440 | 20,176 |
| Unallocated surplus of with-profits funds | - | - | 12,450 | 12,450 | | - | - | 12,061 | 12,061 |
| Total | 17,554 | - | 304,435 | 321,989 | | 17,736 | - | 268,278 | 286,017 |
| Core structural borrowings of shareholder-financed operations | | | | | | | | | |
| Other borrowings: | | | | | | | | | |
| Operational borrowings attributable to shareholder-financed operations | - | - | 4,304 | 4,304 | 4,925 | - | - | 4,636 | 4,636 |
| Borrowings attributable to with-profits operations | - | - | 2,263 | 2,263 | 2,263 | - | - | 2,152 | 2,152 |
| Other non-insurance liabilities: | | | | | | | | | |
| Obligations under funding, securities lending and sale and repurchase | - | - | 1,093 | 1,093 | 1,108 | 18 | - | 877 | 891 |
| | - | - | 2,347 | 2,347 | 2,361 | - | - | 2,074 | 2,074 |

| | | | | | | | | | |
|-------------------------|--------|---|---------|---------|-------|--------|---|---------|---------|
| agreements | | | | | | | | | |
| Net asset value | | | | | | | | | |
| attributable to unit | | | | | | | | | |
| holders of | | | | | | | | | |
| consolidated unit | | | | | | | | | |
| trusts and similar | | | | | | | | | |
| funds | 7,357 | - | - | 7,357 | 7,357 | 5,278 | - | - | 5,278 |
| Deferred tax | | | | | | | | | |
| liabilities | - | - | 4,291 | 4,291 | - | - | - | 3,778 | 3,778 |
| Current tax liabilities | - | - | 617 | 617 | - | - | - | 395 | 395 |
| Accruals and | | | | | | | | | |
| deferred income | - | - | 947 | 947 | - | - | - | 824 | 824 |
| Other creditors | 327 | - | 3,935 | 4,262 | 4,262 | 263 | - | 3,044 | 3,307 |
| Provisions | - | - | 724 | 724 | - | - | - | 635 | 635 |
| Derivative liabilities | 2,323 | - | - | 2,323 | 2,323 | 1,689 | - | - | 1,689 |
| Other liabilities | | | | | | | | | |
| note | | | | | | | | | |
| (vii) | 2,201 | - | 1,904 | 4,105 | 4,105 | 2,051 | - | 1,685 | 3,733 |
| Total | 12,208 | - | 14,765 | 26,973 | | 9,281 | - | 12,435 | 21,711 |
| Liabilities held for | | | | | | | | | |
| sale | 770 | - | - | 770 | 770 | 868 | - | - | 868 |
| Total liabilities | 30,532 | - | 326,860 | 357,392 | | 27,903 | - | 288,378 | 316,281 |

Notes

- (i) Assets carried at cost or amortised cost are subject to impairment testing where appropriate under IFRS requirements. This category also includes assets which are valued by reference to specific IFRS standards such as reinsurers' share of insurance contract liabilities, deferred tax assets and investments accounted for under the equity method.
- (ii) Realised gains and losses on the Group's investments for 2014 recognised in the income statement amounted to a net gain of £2.9 billion (2013: £2.5 billion).
- (iii) The carrying value of investment contracts with discretionary participation features is on IFRS 4 basis. It is impractical to determine the fair value of these contracts due to the lack of a reliable basis to measure participation features.

C3.2 Group assets and liabilities - Measurement

The section provides detail of the designation and valuation of the Group's financial assets and liabilities shown under following categories:

(a) Determination of fair value

The fair values of the assets and liabilities of the Group as shown in this note have been determined on the following bases.

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments, or by using quotations from independent third-parties, such as brokers and pricing services or by using appropriate valuation techniques.

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

The loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The rate of discount used was the market rate of interest where applicable.

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

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

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

(b) Fair value measurement hierarchy of Group assets and liabilities

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

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

Financial instruments at fair value

| | 31 Dec 2014 £m | | | Total |
|-----------------------------------------------------------------------------------|---------------------------------------------------------------------|--------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|---------|
| | Level 1 Quoted prices (unadjusted) in active markets | Level 2 Valuation based on significant observable market inputs | Level 3 Valuation based on significant unobservable market inputs | |
| Analysis of financial investments, net of derivative liabilities by business type | | | | |
| With-profits | | | | |
| Equity securities and portfolio holdings in unit trusts | 31,136 | 2,832 | 694 | 34,662 |
| Debt securities | 16,415 | 42,576 | 582 | 59,573 |
| Other investments (including derivative assets) | 96 | 1,997 | 3,252 | 5,345 |
| Derivative liabilities | (72) | (1,024) | - | (1,096) |
| Total financial investments, net of derivative liabilities | 47,575 | 46,381 | 4,528 | 98,484 |
| Percentage of total | 48% | 47% | 5% | 100% |
| Unit-linked and variable annuity separate account | | | | |
| Equity securities and portfolio holdings in unit trusts | 108,392 | 336 | 21 | 108,749 |
| Debt securities | 4,509 | 6,375 | 11 | 10,895 |
| Other investments (including derivative assets) | 4 | 29 | - | 33 |
| Derivative liabilities | (10) | (12) | - | (22) |
| Total financial investments, net of derivative liabilities | 112,895 | 6,728 | 32 | 119,655 |
| Percentage of total | 94% | 6% | 0% | 100% |
| Non-linked shareholder-backed | | | | |
| Loans | - | 266 | 2,025 | 2,291 |
| Equity securities and portfolio holdings in unit trusts | 1,303 | 116 | 32 | 1,451 |
| Debt securities | 15,806 | 58,780 | 197 | 74,783 |
| Other investments (including derivative assets) | - | 1,469 | 776 | 2,245 |
| Derivative liabilities | - | (867) | (338) | (1,205) |
| Total financial investments, net of derivative liabilities | 17,109 | 59,764 | 2,692 | 79,565 |
| Percentage of total | 22% | 75% | 3% | 100% |

Group total analysis, including other financial liabilities held at fair value

| | | | | |
|--------------------------------------------------------------------------------------------------|---------|----------|---------|----------|
| Group total | | | | |
| Loans* | - | 266 | 2,025 | 2,291 |
| Equity securities and portfolio holdings in unit trusts | 140,831 | 3,284 | 747 | 144,862 |
| Debt securities | 36,730 | 107,731 | 790 | 145,251 |
| Other investments (including derivative assets) | 100 | 3,495 | 4,028 | 7,623 |
| Derivative liabilities | (82) | (1,903) | (338) | (2,323) |
| Total financial investments, net of derivative liabilities | 177,579 | 112,873 | 7,252 | 297,704 |
| Investment contracts liabilities without discretionary participation features held at fair value | - | (17,554) | - | (17,554) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (5,395) | (671) | (1,291) | (7,357) |
| Other financial liabilities held at fair value | - | (327) | (2,201) | (2,528) |
| Total financial instruments at fair value | 172,184 | 94,321 | 3,760 | 270,265 |
| Percentage of total | 64% | 35% | 1% | 100% |

*Loans in the above table are those classified as fair value through profit and loss in note C3.1.

In addition to the financial instruments shown above, the assets and liabilities held for sale on the consolidated statement of financial position at 31 December 2014 in respect of Japan Life business included a net financial instruments balance of £844 million, primarily for equity securities and debt securities. Of this amount, £814 million has been classified as level 1 and £30 million as level 2.

| | 31 Dec 2013 £m | | | Total |
|-----------------------------------------------------------------------------------|----------------------------------------------|---------------------------------------------|-----------------------------------------------|---------|
| | Level 1 | Level 2 | Level 3 | |
| | Quoted prices (unadjusted) in active markets | Valuation based on observable market inputs | Valuation based on unobservable market inputs | |
| Analysis of financial investments, net of derivative liabilities by business type | | | | |
| With-profits | | | | |
| Equity securities and portfolio holdings in unit trusts | 25,087 | 2,709 | 569 | 28,365 |
| Debt securities | 14,547 | 42,759 | 485 | 57,791 |
| Other investments (including derivative assets) | 169 | 1,191 | 2,949 | 4,309 |
| Derivative liabilities | (32) | (517) | - | (549) |
| Total financial investments, net of derivative liabilities | 39,771 | 46,142 | 4,003 | 89,916 |
| Percentage of total | 44% | 52% | 4% | 100% |
| Unit-linked and variable annuity separate account | | | | |
| Equity securities and portfolio holdings in unit trusts | 90,645 | 191 | 36 | 90,872 |
| Debt securities | 3,573 | 6,048 | 1 | 9,622 |
| Other investments (including derivative assets) | 6 | 30 | - | 36 |
| Derivative liabilities | (1) | (3) | - | (4) |
| Total financial investments, net of derivative liabilities | 94,223 | 6,266 | 37 | 100,526 |
| Percentage of total | 94% | 6% | 0% | 100% |
| Non-linked shareholder-backed | | | | |
| Loans | - | 250 | 1,887 | 2,137 |

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| | | | | |
|------------------------------------------------------------|--------|--------|-------|---------|
| Equity securities and portfolio holdings in unit trusts | 841 | 100 | 44 | 985 |
| Debt securities | 13,428 | 51,880 | 184 | 65,492 |
| Other investments (including derivative assets) | - | 1,111 | 809 | 1,920 |
| Derivative liabilities | - | (935) | (201) | (1,136) |
| Total financial investments, net of derivative liabilities | 14,269 | 52,406 | 2,723 | 69,398 |
| Percentage of total | 21% | 75% | 4% | 100% |

Group total analysis, including other financial liabilities held at fair value

| | | | | |
|--------------------------------------------------------------------------------------------------|---------|----------|---------|----------|
| Group total | | | | |
| Loans* | - | 250 | 1,887 | 2,137 |
| Equity securities and portfolio holdings in unit trusts | 116,573 | 3,000 | 649 | 120,222 |
| Debt securities | 31,548 | 100,687 | 670 | 132,905 |
| Other investments (including derivative assets) | 175 | 2,332 | 3,758 | 6,265 |
| Derivative liabilities | (33) | (1,455) | (201) | (1,689) |
| Total financial investments, net of derivative liabilities | 148,263 | 104,814 | 6,763 | 259,840 |
| Investment contracts liabilities without discretionary participation features held at fair value | - | (17,736) | - | (17,736) |
| Borrowings attributable to the with-profits funds held at fair value | - | (18) | - | (18) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (3,703) | (248) | (1,327) | (5,278) |
| Other financial liabilities held at fair value | - | (263) | (2,051) | (2,314) |
| Total financial instruments at fair value | 144,560 | 86,549 | 3,385 | 234,494 |
| Percentage of total | 61% | 37% | 2% | 100% |

*Loans in the above table are those classified as fair value through profit or loss in note C3.1.

Investment properties at fair value

| | £m | | | Total |
|------|----------------------------------------------|-----------------------------------------------|----------------------------------------------------|--------|
| | Level 1 | Level 2 | Level 3 | |
| | Quoted prices (unadjusted) in active markets | based on significant observable market inputs | Valuation based on significant unobservable inputs | |
| 2014 | - | - | 12,764 | 12,764 |
| 2013 | - | - | 11,477 | 11,477 |

(c) Valuation approach for Level 2 fair valued assets and liabilities

A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes.

These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain the third-party broker quotes. Where pricing services providers are used, a single valuation is obtained and applied.

When prices are not available from pricing services, quotes are sourced directly from brokers. Prudential seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on

their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness and regularity of the quotes and the accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

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

Of the total level 2 debt securities of £107,731 million at 31 December 2014 (2013: £100,687 million), £10,093 million are valued internally (2013: £8,556 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

(d) Fair value measurements for level 3 fair valued assets and liabilities

Valuation approach for level 3 fair valued assets and liabilities

Financial instruments at fair value

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

The fair value estimates are made at a specific point in time, based upon available market information and judgments about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time the Group's entire holdings of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued. In some cases the disclosed value cannot be realised in immediate settlement of the financial instrument.

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

valuations.

At 31 December 2014, the Group held £3,760 million (2013: £3,385 million) of net financial instruments at fair value within level 3. This represents 1 per cent (2013: 2 per cent) of the total fair valued financial assets net of fair valued financial liabilities.

Included within these amounts were loans of £2,025 million at 31 December 2014 (2013: £1,887 million), measured as the loan outstanding balance, attached to REALIC and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,201 million at 31 December 2014 (2013: £2,051 million) was also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

Excluding the loans and funds withheld liability under REALIC's reinsurance arrangements as described above, which amounted to a net liability of £(176) million (2013: £(164) million), the level 3 fair valued financial assets net of financial liabilities were £3,936 million (2013: £3,549 million). Of this amount, a net asset of £11 million (2013: net liability of £(304) million) were internally valued, representing less than 0.1 per cent of the total fair valued financial assets net of financial liabilities (2013: 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net asset / liability were:

- (a) Debt securities of £298 million (2013: £118 million), which were either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured).
- (b) Private equity and venture investments of £1,002 million (2013: £878 million) which were valued internally based on management information available for these investments. These investments were principally held by consolidated investment funds which are managed on behalf of third-parties.
- (c) Liabilities of £(1,269) million (2013: £(1,301) million) for the net asset value attributable to external unit holders in respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets.
- (d) Derivative liabilities of £(23) million (2013: nil) which are valued internally using standard market practices but are subject to independent assessment against external counterparties valuations.
- (e) Other sundry individual financial investments of £3 million (2013: £1 million).

Of the internally valued net asset referred to above of £11 million (2013: net liability of £(304) million):

- (a) A net liability of £(133) million (2013: net liability of £(380) million) was held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments.
- (b) A net asset of £144 million (2013: £76 million) was held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally was varied downwards by 10 per cent, the change in valuation would be £14 million (2013: £8 million), which would reduce shareholders' equity by this amount before tax. Of this amount, a decrease of £13 million (2013: a decrease of £6 million) would pass through the income statement substantially as part of short-term fluctuations in investment returns outside of operating profit and a £1 million decrease (2013: a decrease of £2 million) would be included as part of other comprehensive income, being unrealised movements on assets classified as available-for-sale.

Other assets at fair value - Investment properties

The investment properties of the Group are principally held by the UK insurance operations which are externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors (RICS) valuation standards. An 'income capitalisation' technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the

Group's investment properties. As the comparisons are not with properties which are virtually identical to Group's investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.

(e) Transfers into and transfers out of levels

The Group's policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer.

During 2014, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to 2 of £618 million and transfers from level 2 to level 1 of £223 million. These transfers which relate to equity securities and debt securities arose to reflect the change in the observability of the inputs used in valuing these securities.

In addition, in 2014, the transfers into level 3 were £13 million and the transfers out of level 3 were £34 million. These transfers were between levels 3 and 2 and primarily for equity securities and debt securities.

(f) Valuation processes applied by the Group

The Group's valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by Business Unit committees as part of the Group's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions.

C3.3

Debt securities

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

Debt securities are carried at fair value. The amounts included in the statement of financial position are analysed as follows, with further information relating to the credit quality of the Group's debt securities at 31 December 2014 provided in the notes below.

| | | 2014 | 2013 |
|-----------------------------|---------------|---------|---------|
| | | £m | £m |
| Insurance operations: | | | |
| | Asia note (a) | 23,629 | 18,554 |
| | US note (b) | 32,980 | 30,292 |
| | UK note (c) | 86,349 | 82,014 |
| Asset management operations | note (d) | 2,293 | 2,045 |
| Total | | 145,251 | 132,905 |

In the tables below, with the exception of some mortgage-backed securities, Standard & Poor's (S&P) ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative.

(a) Asia insurance operations

| | 2014 £m | | | 2013 | |
|--|--------------|-------------|-------|-------|-------|
| | With-profits | Unit-linked | Other | Total | Total |
| | | | | | £m |

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| | business | assets | business | | |
|------------------------|----------|--------|----------|--------|--------|
| S&P - AAA | 728 | 48 | 186 | 962 | 724 |
| S&P - AA+ to AA- | 5,076 | 323 | 933 | 6,332 | 4,733 |
| S&P - A+ to A- | 1,980 | 367 | 1,575 | 3,922 | 2,896 |
| S&P - BBB+ to BBB- | 1,667 | 755 | 1,123 | 3,545 | 2,717 |
| S&P - Other | 499 | 251 | 1,089 | 1,839 | 1,433 |
| | 9,950 | 1,744 | 4,906 | 16,600 | 12,503 |
| Moody's - Aaa | 757 | 194 | 331 | 1,282 | 1,728 |
| Moody's - Aa1 to Aa3 | 42 | 14 | 1,085 | 1,141 | 176 |
| Moody's - A1 to A3 | 193 | 90 | 83 | 366 | 177 |
| Moody's - Baa1 to Baa3 | 167 | 276 | 142 | 585 | 572 |
| Moody's - Other | 49 | 13 | 6 | 68 | 76 |
| | 1,208 | 587 | 1,647 | 3,442 | 2,729 |
| Fitch | 559 | 110 | 340 | 1,009 | 728 |
| Other | 1,210 | 406 | 962 | 2,578 | 2,594 |
| Total debt securities | 12,927 | 2,847 | 7,855 | 23,629 | 18,554 |

In addition to the debt securities shown above, the assets held for sale on the consolidated statement of financial position at 31 December 2014 in respect of Japan Life business included a debt securities balance of £351 million (2013: £387 million). Of this amount, £321 million were rated as AA+ to AA- (2013: £356 million) and £30 million (2013: £29 million) were rated A+ to A-.

The following table analyses debt securities of 'Other business' which are not externally rated by S&P, Moody's or Fitch.

| | 2014 £m | 2013 £m |
|------------------|---------|---------|
| Government bonds | 174 | 387 |
| Corporate bonds* | 654 | 491 |
| Other | 134 | 81 |
| | 962 | 959 |

* Rated as investment grade by local external ratings agencies.

(b) US insurance operations

(i) Overview

| | 2014 £m | 2013 £m |
|---------------------------------------------------------|------------|------------|
| Corporate and government security and commercial loans: | | |
| Government | 3,972 | 3,330 |
| Publicly traded and SEC Rule 144A securities* | 20,745 | 18,875 |
| Non-SEC Rule 144A securities | 3,745 | 3,395 |
| Total | 28,462 | 25,600 |
| Residential mortgage-backed securities (RMBS) | 1,567 | 1,760 |
| Commercial mortgage-backed securities (CMBS) | 2,343 | 2,339 |
| Other debt securities | 608 | 593 |
| Total US debt securities† | 32,980 | 30,292 |

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

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

| | 2014 | 2013 |
|--------------------------------------------------------------------------------------|--------|--------|
| | £m | £m |
| Available-for-sale | 32,897 | 30,205 |
| Fair value through profit or loss: | | |
| Securities held to back liabilities for funds withheld under reinsurance arrangement | 83 | 87 |
| | 32,980 | 30,292 |

(ii) Valuation basis, presentation of gains and losses and securities in an unrealised loss position

Under IAS 39, unless categorised as 'held to maturity' or 'loans and receivables' debt securities are required to be fair valued. Where available, quoted market prices are used. However, where securities do not have an externally quoted price based on regular trades or where markets for the securities are no longer active as a result of market conditions, IAS 39 requires that valuation techniques be applied. IFRS 13 requires classification of the fair values applied by the Group into a three level hierarchy. At 31 December 2014, 0.1 per cent of Jackson's debt securities were classified as level 3 (31 December 2013: 0.1 per cent) comprising of fair values where there are significant inputs which are not based on observable market data.

Except for certain assets covering liabilities that are measured at fair value, the debt securities of the US insurance operations are classified as available-for-sale. Unless impaired, fair value movements are recognised in other comprehensive income. Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

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

There was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £781 million to a net unrealised gain of £1,840 million as analysed in the table below. This increase reflects the effects of decreasing long-term interest rates.

| | 2014 | Changes in unrealised appreciation** | Foreign exchange translation | 2013 |
|--------------------------------------------------------------------------------------------------------------|--------|-------------------------------------------------------------|------------------------------|--------|
| | £m | £m | £m | £m |
| | | Reflected as part of movement in other comprehensive income | | |
| Assets fair valued at below book value | | | | |
| Book value* | 5,899 | | | 10,825 |
| Unrealised (loss) gain | (180) | 683 | (14) | (849) |
| Fair value (as included in statement of financial position) | 5,719 | | | 9,976 |
| Assets fair valued at or above book value | | | | |
| Book value* | 25,158 | | | 18,599 |
| Unrealised gain | 2,020 | 273 | 117 | 1,630 |
| Fair value (as included in statement of financial position) | 27,178 | | | 20,229 |
| Total | | | | |
| Book value* | 31,057 | | | 29,424 |
| Net unrealised gain | 1,840 | 956 | 103 | 781 |
| Fair value (as included in the footnote above in the overview table and the statement of financial position) | 32,897 | | | 30,205 |

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

** Translated at the average rate of US\$1.6476: £1.00

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

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

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

| | 2014 £m | | 2013 £m | |
|----------------------------------------|------------|-----------------|------------|-----------------|
| | Fair value | Unrealised loss | Fair value | Unrealised loss |
| Between 90% and 100% | 5,429 | (124) | 7,624 | (310) |
| Between 80% and 90% | 245 | (37) | 1,780 | (331) |
| Below 80% : | | | | |
| Residential mortgage-backed securities | | | | |
| Sub-prime | 4 | (1) | 4 | (1) |
| Commercial mortgage-backed securities | 10 | (3) | 16 | (6) |
| Other asset-backed securities | 9 | (6) | 9 | (6) |
| Government bonds | - | - | 521 | (188) |
| Corporates | 22 | (9) | 22 | (7) |
| | 45 | (19) | 572 | (208) |
| Total | 5,719 | (180) | 9,976 | (849) |

(b) Unrealised losses by maturity of security

| | 2014 £m | 2013 £m |
|-------------------------------------------|---------|---------|
| 1 year to 5 years | (5) | (5) |
| 5 years to 10 years | (90) | (224) |
| More than 10 years | (54) | (558) |
| Mortgage-backed and other debt securities | (31) | (62) |
| Total | (180) | (849) |

(c) Age analysis of unrealised losses for the periods indicated

The following table shows the age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

| | 2014 £m | | | 2013 £m | | |
|--------------------|----------------------|------------------|-------|----------------------|------------------|-------|
| | Non-investment grade | Investment grade | Total | Non-investment grade | Investment grade | Total |
| Less than 6 months | (18) | (46) | (64) | (2) | (52) | (54) |
| 6 months to 1 year | (1) | (1) | (2) | (12) | (329) | (341) |
| 1 year to 2 years | (6) | (51) | (57) | (2) | (423) | (425) |
| 2 years to 3 years | (1) | (36) | (37) | (1) | - | (1) |
| More than 3 years | (7) | (13) | (20) | (13) | (15) | (28) |
| Total | (33) | (147) | (180) | (30) | (819) | (849) |

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Further, the following table shows the age analysis as at 31 December 2014, of the securities whose fair values were below 80 per cent of the book value:

| Age analysis | 2014 £m | | 2013 £m | |
|----------------------|------------|-----------------|------------|-----------------|
| | Fair value | Unrealised loss | Fair value | Unrealised loss |
| Less than 3 months | 17 | (7) | 93 | (24) |
| 3 months to 6 months | 3 | (1) | 418 | (159) |
| More than 6 months | 25 | (11) | 61 | (25) |
| | 45 | (19) | 572 | (208) |

(iii) Ratings

The following table summarises the securities detailed above by rating using S&P, Moody's, Fitch and implicit ratings of mortgage-backed securities based on National Association of Insurance Commissioners (NAIC) valuations:

| | 2014 £m | 2013 £m |
|---------------------------------------------------------------|---------|---------|
| S&P - AAA | 164 | 132 |
| S&P - AA+ to AA- | 6,067 | 5,252 |
| S&P - A+ to A- | 8,640 | 7,728 |
| S&P - BBB+ to BBB- | 10,308 | 9,762 |
| S&P - Other | 1,016 | 941 |
| | 26,195 | 23,815 |
| Moody's - Aaa | 84 | 65 |
| Moody's - Aa1 to Aa3 | 29 | 13 |
| Moody's - A1 to A3 | 27 | 65 |
| Moody's - Baa1 to Baa3 | 72 | 70 |
| Moody's - Other | 8 | 10 |
| | 220 | 223 |
| Implicit ratings of MBS based on NAIC* valuations (see below) | | |
| NAIC 1 | 2,786 | 2,774 |
| NAIC 2 | 85 | 179 |
| NAIC 3-6 | 58 | 87 |
| | 2,929 | 3,040 |
| Fitch | 300 | 159 |
| Other ** | 3,336 | 3,055 |
| Total debt securities (see overview table in note (i) above) | 32,980 | 30,292 |

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

** The amounts within 'Other' which are not rated by S&P, Moody's nor Fitch, nor are MBS securities using the revised regulatory ratings, have the following NAIC classifications:

| | 2014 £m | 2013 £m |
|----------|---------|---------|
| NAIC 1 | 1,322 | 1,165 |
| NAIC 2 | 1,890 | 1,836 |
| NAIC 3-6 | 124 | 54 |
| | 3,336 | 3,055 |

For some mortgage-backed securities within Jackson, the table above includes these securities using the regulatory ratings detail issued by the NAIC. These regulatory ratings levels were established by external third parties (PIMCO for residential mortgage-backed securities and BlackRock Solutions for commercial mortgage-backed securities).

(c) UK insurance operations

| | 2014 £m | | | | | | UK insurance operations | |
|------------------------|----------------------------------|-----------------------|------------------------------|--------|--------------------------------------|---------------|-------------------------|--|
| | Scottish Amicable Insurance Fund | PAC with-profits fund | Other funds and subsidiaries | | | 2014 Total £m | 2013 Total £m | |
| | | | Unit-linked assets | PRIL | Other annuity and long-term business | | | |
| S&P - AAA | 231 | 3,984 | 1,257 | 3,516 | 388 | 9,376 | 8,837 | |
| S&P - AA+ to AA- | 506 | 5,443 | 1,118 | 3,724 | 458 | 11,249 | 10,690 | |
| S&P - A+ to A- | 752 | 10,815 | 1,764 | 7,324 | 836 | 21,491 | 20,891 | |
| S&P - BBB+ to BBB- | 585 | 9,212 | 1,898 | 4,332 | 714 | 16,741 | 17,125 | |
| S&P - Other | 158 | 2,177 | 215 | 272 | 45 | 2,867 | 3,255 | |
| | 2,232 | 31,631 | 6,252 | 19,168 | 2,441 | 61,724 | 60,798 | |
| Moody's - Aaa | 59 | 1,375 | 200 | 377 | 52 | 2,063 | 2,333 | |
| Moody's - Aa1 to Aa3 | 52 | 2,370 | 1,110 | 3,048 | 549 | 7,129 | 6,420 | |
| Moody's - A1 to A3 | 48 | 970 | 88 | 1,412 | 168 | 2,686 | 2,077 | |
| Moody's - Baa1 to Baa3 | 31 | 807 | 126 | 363 | 49 | 1,376 | 1,214 | |
| Moody's - Other | 6 | 390 | 14 | 26 | - | 436 | 140 | |
| | 196 | 5,912 | 1,538 | 5,226 | 818 | 13,690 | 12,184 | |
| Fitch | 15 | 484 | 97 | 232 | 20 | 848 | 611 | |
| Other | 266 | 5,910 | 161 | 3,464 | 286 | 10,087 | 8,421 | |
| Total debt securities | 2,709 | 43,937 | 8,048 | 28,090 | 3,565 | 86,349 | 82,014 | |

Where no external ratings are available, internal ratings produced by the Group's asset management operation, which are prepared on the Company's assessment of a comparable basis to external ratings, are used where possible. The £10,087 million total debt securities held at 31 December 2014 (2013: £8,421 million) which are not externally rated are either internally rated or unrated. These are analysed as follows:

| | 2014 £m | 2013 £m |
|------------------------------|---------|---------|
| Internal ratings or unrated: | | |
| AAA to A- | 4,917 | 3,691 |
| BBB to B- | 3,755 | 3,456 |
| Below B- or unrated | 1,415 | 1,274 |
| Total | 10,087 | 8,421 |

The majority of unrated debt security investments were held in SAIF and the PAC with-profits fund and relate to convertible debt and other investments which are not covered by ratings analysts nor have an internal rating attributed to them. The non-linked shareholder-backed business of PRIL and other annuity and long-term business includes £3,750 million which are not externally rated. The internal ratings for these securities consists of £1,082 million AA+ to AA-, £1,336 million A+ to A-, £1,183 million BBB+ to BBB-, £60 million BB+ to BB- and £89 million that were rated B+ and below or unrated.

(d) Asset management operations

The debt securities are all held by M&G (including Prudential Capital).

| | 2014 | 2013 |
|------------------------------------------|-------|-------|
| | £m | £m |
| M&G | | |
| AAA to A- by S&P or equivalent ratings | 2,056 | 1,690 |
| Other | 237 | 355 |
| Total M&G (including Prudential Capital) | 2,293 | 2,045 |

(e) Asset-backed securities

The Group's holdings in Asset-Backed Securities (ABS), which comprise Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS), Collateralised Debt Obligations (CDO) funds and other asset-backed securities, at 31 December 2014 is as follows:

| | 2014 | 2013 |
|-----------------------------------------------------------|--------|--------|
| | £m | £m |
| Shareholder-backed operations: | | |
| Asia insurance operations note (i) | 104 | 139 |
| US insurance operations note (ii) | 4,518 | 4,692 |
| UK insurance operations (2014: 25% AAA, 42% AA)note (iii) | 1,864 | 1,727 |
| Other operations note (iv) | 875 | 667 |
| | 7,361 | 7,225 |
| With-profits operations: | | |
| Asia insurance operations note (i) | 228 | 200 |
| UK insurance operations (2014: 57% AAA, 17% AA)note (iii) | 5,126 | 5,765 |
| | 5,354 | 5,965 |
| Total | 12,715 | 13,190 |

Notes

(i) Asia insurance operations

The Asia insurance operations' exposure to asset-backed securities is primarily held by the with-profits operations. Of the £228 million, 99 per cent (31 December 2013: 94 per cent) are investment graded.

(ii) US insurance operations

US insurance operations' exposure to asset-backed securities at 31 December 2014 comprises:

| | 2014 | 2013 |
|---------------------------------------------------------------------------------------|-------|-------|
| | £m | £m |
| RMBS | | |
| Sub-prime (2014: 7% AAA, 11% AA, 8% A) | 235 | 255 |
| Alt-A (2014: 1% AA, 4% A) | 244 | 270 |
| Prime including agency (2014: 76% AA, 2% A) | 1,088 | 1,235 |
| CMBS (2014: 50% AAA, 23% AA, 22% A) | 2,343 | 2,339 |
| CDO funds (2014: 21% AAA, 1% AA, 23% A), including £nil exposure to sub-prime | 53 | 46 |
| Other ABS (2014: 27% AAA, 17% AA, 45% A), including £72 million exposure to sub-prime | 555 | 547 |
| Total | 4,518 | 4,692 |

(iii) UK insurance operations

The majority of holdings of the shareholder-backed business relates to the UK market and primarily relates to investments held by PRIL.

Of the holdings of the with-profits operations, £1,333 million (31 December 2013: £1,490 million) relates to exposure to the US markets with the remaining exposure being primarily to the UK market.

(iv) Other operations

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Asset management operations' exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £875 million, 89 per cent (31 December 2013: 85 per cent) are graded AAA.

(f) Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities at 31 December 2014:

Exposure to sovereign debts

| | 2014 £m | | 2013 £m | |
|--------------------------------------|-----------------------------|--------------------|-----------------------------|--------------------|
| | Shareholder-backed business | With-profits funds | Shareholder-backed business | With-profits funds |
| Italy | 62 | 61 | 53 | 53 |
| Spain | 1 | 18 | 1 | 14 |
| France | 20 | - | 19 | - |
| Germany* | 388 | 336 | 413 | 389 |
| Other Eurozone (principally Belgium) | 5 | 29 | 5 | 28 |
| Total Eurozone | 476 | 444 | 491 | 484 |
| United Kingdom | 4,104 | 2,065 | 3,516 | 2,432 |
| United States** | 3,607 | 5,771 | 3,045 | 4,026 |
| Other, predominantly Asia | 2,787 | 1,714 | 3,124 | 1,525 |
| Total | 10,974 | 9,994 | 10,176 | 8,467 |

* Including bonds guaranteed by the federal government.

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

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

Exposure to bank debt securities

| | 2014 £m | | | | | | | 2014 Total £m | 2013 Total £m |
|-----------------------------|-------------|--------|-------------------|-------------------|--------|-------------------------|-------|---------------------|---------------------|
| | Senior debt | | | Subordinated debt | | | | | |
| | Covered | Senior | Total senior debt | Tier 1 | Tier 2 | Total subordinated debt | | | |
| Shareholder-backed business | | | | | | | | | |
| Italy | - | 31 | 31 | - | - | - | 31 | 30 | |
| Spain | 109 | 11 | 120 | - | 13 | 13 | 133 | 135 | |
| France | 20 | 136 | 156 | 17 | 76 | 93 | 249 | 175 | |
| Germany | 17 | 25 | 42 | - | 69 | 69 | 111 | 66 | |
| Netherlands | - | 13 | 13 | 75 | 36 | 111 | 124 | 152 | |
| Other Eurozone | - | 42 | 42 | - | 11 | 11 | 53 | 74 | |
| Total Eurozone | 146 | 258 | 404 | 92 | 205 | 297 | 701 | 632 | |
| United Kingdom | 393 | 235 | 628 | 35 | 633 | 668 | 1,296 | 1,369 | |
| United States | - | 1,905 | 1,905 | 56 | 523 | 579 | 2,484 | 2,163 | |
| Other, predominantly Asia | 19 | 294 | 313 | 56 | 366 | 422 | 735 | 698 | |
| Total | 558 | 2,692 | 3,250 | 239 | 1,727 | 1,966 | 5,216 | 4,862 | |

With-profits funds

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| | | | | | | | | |
|---------------------------|-----|-------|-------|-----|-------|-------|-------|-------|
| Italy | 7 | 60 | 67 | - | - | - | 67 | 82 |
| Spain | 134 | 52 | 186 | - | - | - | 186 | 149 |
| France | 7 | 138 | 145 | - | 61 | 61 | 206 | 237 |
| Germany | 104 | 24 | 128 | - | - | - | 128 | 24 |
| Netherlands | - | 195 | 195 | - | - | - | 195 | 215 |
| Other Eurozone | 5 | 19 | 24 | - | - | - | 24 | 16 |
| Total Eurozone | 257 | 488 | 745 | - | 61 | 61 | 806 | 723 |
| United Kingdom | 549 | 460 | 1,009 | 6 | 546 | 552 | 1,561 | 1,695 |
| United States | - | 1,821 | 1,821 | 116 | 127 | 243 | 2,064 | 2,214 |
| Other, predominantly Asia | 140 | 842 | 982 | 142 | 272 | 414 | 1,396 | 1,102 |
| Total | 946 | 3,611 | 4,557 | 264 | 1,006 | 1,270 | 5,827 | 5,734 |

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

(g) Group oil and gas industries debt exposure

The Group exposures held by the shareholder-backed business in debt securities issued by the oil and gas industries at 31 December 2014 are analysed as follows:

| | 2014 £m | | | | | Total |
|-------------|---------------------------------------------|--------------------------------------|-------------------------------|--------------------------|-----|-------|
| | Exploration and Integrated production | Refining and Marketing oils | Oil and gas services | Pipeline / mid-stream | | |
| AAA | - | 8 | - | - | - | 8 |
| AA | 43 | 244 | - | 90 | 2 | 379 |
| A | 324 | 334 | - | 81 | 21 | 760 |
| BBB | 499 | 281 | 192 | 299 | 659 | 1,930 |
| BB or below | 73 | 4 | 15 | 16 | 212 | 320 |
| Total | 939 | 871 | 207 | 486 | 894 | 3,397 |

The exposure is well diversified by issuer, sub-sector and geography with 138 issuers across the five sub-sectors. The average holding is £25 million.

The exposure by business unit is as follows:

| | 2014 £m | | | Total |
|-------------|--------------------------|---------------------------|-------|-------|
| | US general account | UK (annuities fund) | Other | |
| AAA | 8 | - | - | 8 |
| AA | 199 | 140 | 40 | 379 |
| A | 567 | 153 | 40 | 760 |
| BBB | *1,610 | 161 | 159 | 1,930 |
| BB or below | *280 | 31 | 9 | 320 |
| Total | 2,664 | 485 | 248 | 3,397 |

* Total exposure to the more directly impacted sub-segments of Exploration and Production and Oil and Gas services is £779 million.

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

C3.4 Loans portfolio

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

- Certain mortgage loans which have been designated at fair value through profit or loss of the UK insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and
- Certain policy loans of the US insurance operations which are held to back liabilities for funds withheld under reinsurance arrangement and are also accounted on a fair value basis. See note (b).

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

| | | 2014 | 2013 |
|------------------------------|--------------|--------|--------|
| | | £m | £m |
| Insurance operations: | | | |
| | Asianote (a) | 1,014 | 922 |
| | USnote (b) | 6,719 | 6,375 |
| | UKnote (c) | 4,254 | 4,173 |
| Asset management operations: | | | |
| | M&Gnote (d) | 854 | 1,096 |
| Total | | 12,841 | 12,566 |

(a) Asia insurance operations

The loans of the Group's Asia insurance operations comprise:

| | | 2014 | |
|---------------------------------------|--|-------|---------|
| | | £m | 2013 £m |
| Mortgage loans‡ | | 88 | 57 |
| Policy loans‡ | | 672 | 611 |
| Other loans‡‡ | | 254 | 254 |
| Total Asia insurance operations loans | | 1,014 | 922 |

‡ The mortgage and policy loans are secured by properties and life insurance policies respectively.

‡‡ The majority of the other loans are commercial loans held by the Malaysia operation and which are all investment graded by two local rating agencies.

(b) US insurance operations

The loans of the Group's US insurance operations comprise:

| | 2014 £m | | | 2013 £m | | |
|-----------------|----------------------------------------------------------|----------------|-------|----------------------------------------------------------|----------------|-------|
| | Loans backing liabilities for funds withheld | Other loans | Total | Loans backing liabilities for funds withheld | Other loans | Total |
| Mortgage loans+ | - | 3,847 | 3,847 | - | 3,671 | 3,671 |

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| | | | | | | |
|-------------------------------------|-------|-------|-------|-------|-------|-------|
| Policy loans ⁺⁺ | 2,025 | 847 | 2,872 | 1,887 | 817 | 2,704 |
| Total US insurance operations loans | 2,025 | 4,694 | 6,719 | 1,887 | 4,488 | 6,375 |

†

All of the mortgage loans are commercial mortgage loans which are collateralised by properties. The property types are industrial, multi-family residential, suburban office, retail and hotel.

††

The policy loans are fully secured by individual life insurance policies or annuity policies. Policy loans backing liabilities for funds withheld under reinsurance arrangements are accounted for at fair value through profit or loss. All other policy loans are accounted for at amortised cost, less any impairment.

The US insurance operations' commercial mortgage loan portfolio does not include any single-family residential mortgage loans and is therefore not exposed to the risk of defaults associated with residential sub-prime mortgage loans.

The average loan size is £7.2 million (2013: £6.5 million). The portfolio has a current estimated average loan to value of 59 per cent (2013: 61 per cent).

At 31 December 2014, Jackson had mortgage loans with a carrying value of £13 million (2013: £47 million) where the contractual terms of the agreements had been restructured.

(c) UK insurance operations

The loans of the Group's UK insurance operations comprise:

| | | 2014 £m | 2013 £m |
|-------------------------------------|----------------------------------------------|------------|------------|
| SAIF and PAC WPSF | | | |
| | Mortgage loans [†] | 1,145 | 1,183 |
| | Policy loans | 10 | 12 |
| | Other loans [‡] | 1,510 | 1,629 |
| | Total SAIF and PAC WPSF loans | 2,665 | 2,824 |
| Shareholder-backed operations | | | |
| | Mortgage loans [†] | 1,585 | 1,345 |
| | Other loans | 4 | 4 |
| | Total loans of shareholder-backed operations | 1,589 | 1,349 |
| Total UK insurance operations loans | | 4,254 | 4,173 |

†

The mortgage loans are collateralised by properties. By carrying value, 74 per cent of the £1,585 million held for shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 29 per cent.

‡

Other loans held by the PAC with-profits fund are all commercial loans and comprise mainly syndicated loans.

(d) Asset management operations

The M&G loans relate to loans and receivables managed by Prudential Capital. These assets are generally secured but most have no external credit ratings. Internal ratings prepared by the Group's asset management operations, as part of the risk management process, are:

| | 2014 £m | 2013 £m |
|-----------------------------------------|------------|------------|
| Loans and receivables internal ratings: | | |
| AAA | 101 | 108 |
| AA+ to AA- | - | 28 |

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| | | |
|------------------------------------------------|-----|-------|
| A+ to A- | 161 | - |
| BBB+ to BBB- | 244 | 516 |
| BB+ to BB- | 49 | 174 |
| B and other | 299 | 270 |
| Total M&G (including Prudential Capital) loans | 854 | 1,096 |

C4 Policyholder liabilities and unallocated surplus

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

C4.1 Movement and duration of liabilities

C4.1(a) Group overview

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

| | Insurance operations £m | | | |
|-------------------------------------------------------------------------------------------------|-------------------------|------------|------------|----------|
| | Asia note | US note | UK note | Total |
| | C4.1(b) | C4.1(c) | C4.1(d) | |
| At 1 January 2013 | 34,664 | 92,261 | 144,438 | 271,363 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position | 31,501 | 92,261 | 133,912 | 257,674 |
| - Unallocated surplus of with-profits funds on the consolidated statement of financial position | 63 | - | 10,526 | 10,589 |
| - Group's share of policyholder liabilities of joint ventures§ | 3,100 | - | - | 3,100 |
| Reclassification of Japan life business as held for sale† | (1,026) | - | - | (1,026) |
| Net flows: | | | | |
| Premiums | 6,555 | 15,951 | 7,378 | 29,884 |
| Surrenders | (2,730) | (5,087) | (4,582) | (12,399) |
| Maturities/Deaths | (997) | (1,229) | (8,121) | (10,347) |
| Net flows | 2,828 | 9,635 | (5,325) | 7,138 |
| Shareholders' transfers post tax | (38) | - | (192) | (230) |
| Investment-related items and other movements | 462 | 8,219 | 7,812 | 16,493 |
| Foreign exchange translation differences | (2,231) | (2,704) | (117) | (5,052) |
| Acquisition of Thanachart Lifefnote D1 | 487 | - | - | 487 |
| As at 31 December 2013 / 1 January 2014 | 35,146 | 107,411 | 146,616 | 289,173 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position | 31,910 | 107,411 | 134,632 | 273,953 |
| - Unallocated surplus of with-profits funds on the consolidated statement of financial position | 77 | - | 11,984 | 12,061 |
| - Group's share of policyholder liabilities of joint ventures§ | 3,159 | - | - | 3,159 |
| Reallocation of unallocated surplus for the domestication of the Hong Kong branch* | 1,690 | - | (1,690) | - |
| Net flows: | | | | |
| Premiums | 7,058 | 15,492 | 7,902 | 30,452 |
| Surrenders | (2,425) | (5,922) | (5,656) | (14,003) |
| Maturities/Deaths | (1,259) | (1,307) | (6,756) | (9,322) |

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| | | | | |
|-------------------------------------------------------------------------------------------------|--------|---------|---------|---------|
| Net flows | 3,374 | 8,263 | (4,510) | 7,127 |
| Shareholders' transfers post tax | (40) | - | (200) | (240) |
| Investment-related items and other movements | 3,480 | 3,712 | 14,310 | 21,502 |
| Foreign exchange translation differences | 1,372 | 7,360 | (90) | 8,642 |
| At 31 December 2014 | 45,022 | 126,746 | 154,436 | 326,204 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position ¶ | 38,705 | 126,746 | 144,088 | 309,539 |
| - Unallocated surplus of with-profits funds on the consolidated statement of financial position | 2,102 | - | 10,348 | 12,450 |
| - Group's share of policyholder liabilities of joint ventures § | 4,215 | - | - | 4,215 |
| Average policyholder liability balances‡ | | | | |
| 2014 | 38,993 | 117,079 | 139,362 | 295,434 |
| 2013 | 34,423 | 99,836 | 134,272 | 268,531 |

* Up until 31 December 2013 for the purposes of the presentation of unallocated surplus of with-profits within the statement of financial position, the Hong Kong branch balance was reported within the unallocated surplus of the PAC WPSF of the UK insurance operations.

On 1 January 2014, following consultation with the policyholders of PAC and regulators and court approval, the Hong Kong branch of PAC was transferred to separate subsidiaries established in Hong Kong. From this date, the unallocated surplus of the Hong Kong with-profits business is reported within the Asia insurance operations segment.

†

Liabilities of £1,026 million in respect of the Japan life operation at 1 January 2013 were removed from policyholder liabilities following its reclassification as held for sale at 31 December 2013. No further amounts are shown within the 2014 or 2013 analysis above in respect of Japan life business.

‡

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

§

The Group's investment in joint ventures are accounted for on an equity method basis in the Group's balance sheet. The Group's share of the policyholder liabilities

as shown above relate to the joint venture life businesses in China, India and of the Takaful business in Malaysia.

¶ The policyholder liabilities of the Asia insurance operations of £38,705 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,363 million to the Hong Kong with-profits business. Including this amount total Asia policyholder liabilities are £40,068 million.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the year. The items above are shown gross of external reinsurance.

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

(ii) Analysis of movements in policyholder liabilities for shareholder-backed business

| Shareholder-backed business | 2013 £m | | | |
|-----------------------------|---------|--------|--------|---------|
| | Asia | US | UK | Total |
| At 1 January | 21,213 | 92,261 | 49,505 | 162,979 |

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| | | | | | | | |
|----------------------------------------------------------|--------------------------------------------------------------------------------|------|---------|---------|---------|---------|----------|
| Reclassification of Japan life business as held for sale | | note | | | | | |
| Net flows: | | (a) | (1,026) | - | - | (1,026) | |
| | Premiums | | 4,728 | 15,951 | 3,628 | 24,307 | |
| | Surrenders | | (2,016) | (5,087) | (2,320) | (9,423) | |
| | Maturities/Deaths | | (363) | (1,229) | (2,346) | (3,938) | |
| Net flows | | note | (b) | 2,349 | 9,635 | (1,038) | 10,946 |
| Investment-related items and other movements | | | | 622 | 8,219 | 2,312 | 11,153 |
| Acquisition of subsidiaries | | | | 487 | - | - | 487 |
| Foreign exchange translation differences | | | | (1,714) | (2,704) | - | (4,418) |
| At 31 December | | | | 21,931 | 107,411 | 50,779 | 180,121 |
| Comprising: | | | | | | | |
| | - Policyholder liabilities on the consolidated statement of financial position | | | 18,772 | 107,411 | 50,779 | 176,962 |
| | - Group's share of policyholder liabilities relating to joint ventures | | | 3,159 | - | - | 3,159 |
| | | | | | | | |
| | | | | | 2014 £m | | |
| Shareholder-backed business | | | | Asia | US | UK | Total |
| At 1 January | | | | 21,931 | 107,411 | 50,779 | 180,121 |
| Net flows: | | | | | | | |
| | Premiums | | | 4,799 | 15,492 | 4,951 | 25,242 |
| | Surrenders | | | (2,218) | (5,922) | (3,149) | (11,289) |
| | Maturities/Deaths | | | (644) | (1,307) | (2,412) | (4,363) |
| Net flows | | note | (b) | 1,937 | 8,263 | (610) | 9,590 |
| Investment-related items and other movements | | | | 1,859 | 3,712 | 4,840 | 10,411 |
| Foreign exchange translation differences | | | | 683 | 7,360 | - | 8,043 |
| At 31 December | | note | (c) | 26,410 | 126,746 | 55,009 | 208,165 |
| Comprising: | | | | | | | |
| | - Policyholder liabilities on the consolidated statement of financial position | | | 22,195 | 126,746 | 55,009 | 203,950 |
| | - Group's share of policyholder liabilities relating to joint ventures | | | 4,215 | - | - | 4,215 |

Notes

(a) The £1,026 million liabilities of the Japan life operation at 1 January 2013 were removed from policyholder liabilities following its reclassification as held for sale at 31 December 2013. No further amounts are shown within 2014 or 2013 analysis above in respect of Japan life business.

(b) Including net flows of the Group's insurance joint ventures.

(c)

Policyholder liabilities relating to shareholder-backed business grew by £28.1 billion from £180.1 billion at 31 December 2013 to £208.2 billion at 31 December 2014 demonstrating the on-going growth of our business. The increase reflects positive net flows (premiums net of upfront charges less surrenders, withdrawals, maturities and deaths) of £9.6 billion in 2014 (2013: £10.9 billion), driven by strong inflows of £8.3 billion in the US and £1.9 billion in Asia.

C4.1(b) Asia insurance operations

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

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

| | With-profits business £m | Unit-linked liabilities £m | Other business £m | Total £m |
|-------------------------------------------------------------------------------------------------|--------------------------------|----------------------------------|-------------------------|-------------|
| At 1 January 2013 | 13,451 | 14,028 | 7,185 | 34,664 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position | 13,388 | 11,969 | 6,144 | 31,501 |
| - Unallocated surplus of with-profits funds on the consolidated statement of financial position | 63 | - | - | 63 |
| - Group's share of policyholder liabilities relating to joint ventures‡ | - | 2,059 | 1,041 | 3,100 |
| Reclassification of Japan life business as held for sale* | - | (366) | (660) | (1,026) |
| Premiums | | | | |
| New business | 242 | 1,519 | 902 | 2,663 |
| In-force | 1,585 | 1,301 | 1,006 | 3,892 |
| | 1,827 | 2,820 | 1,908 | 6,555 |
| Surrenders note (e) | (714) | (1,799) | (217) | (2,730) |
| Maturities/Deaths | (634) | (46) | (317) | (997) |
| Net flows note (d) | 479 | 975 | 1,374 | 2,828 |
| Shareholders' transfers post tax | (38) | - | - | (38) |
| Investment-related items and other movements note (f) | (160) | 369 | 253 | 462 |
| Acquisition of Thanachart lifenote (g) | - | - | 487 | 487 |
| Foreign exchange translation differences note (a) | (517) | (1,241) | (473) | (2,231) |
| At 31 December 2013 / 1 January 2014 | 13,215 | 13,765 | 8,166 | 35,146 |
| note (c) | | | | |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position | 13,138 | 11,918 | 6,854 | 31,910 |
| - Unallocated surplus of with-profits funds on the consolidated statement of financial position | 77 | - | - | 77 |
| - Group's share of policyholder liabilities relating to joint ventures‡ | - | 1,847 | 1,312 | 3,159 |
| Reallocation of unallocated surplus for the domestication of the Hong Kong branchnote (b) | 1,690 | - | - | 1,690 |
| Premiums | | | | |
| New business | 425 | 1,337 | 997 | 2,759 |
| In-force | 1,834 | 1,375 | 1,090 | 4,299 |
| | 2,259 | 2,712 | 2,087 | 7,058 |
| Surrenders note (e) | (207) | (1,939) | (279) | (2,425) |
| Maturities/Deaths | (615) | (40) | (604) | (1,259) |
| Net flows note (d) | 1,437 | 733 | 1,204 | 3,374 |
| Shareholders' transfers post tax | (40) | - | - | (40) |
| Investment-related items and other movements note (f) | 1,621 | 1,336 | 523 | 3,480 |

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| | | | | |
|-------------------------------------------------------------------------------------------------|--------|--------|--------|--------|
| Foreign exchange translation differences note (a) | 689 | 375 | 308 | 1,372 |
| At 31 December 2014 | | | | |
| note (c) | 18,612 | 16,209 | 10,201 | 45,022 |
| Comprising: | | | | |
| - Policyholder liabilities on the consolidated statement of financial position | | | | |
| § | 16,510 | 13,874 | 8,321 | 38,705 |
| - Unallocated surplus of with-profits funds on the consolidated statement of financial position | 2,102 | - | - | 2,102 |
| - Group's share of policyholder liabilities relating to joint ventures ‡ | - | 2,335 | 1,880 | 4,215 |
| Average policyholder liability balances † | | | | |
| 2014 | 14,823 | 14,987 | 9,183 | 38,993 |
| 2013 | 13,263 | 13,714 | 7,446 | 34,423 |

* The £1,026 million liabilities of the Japan life operation at 1 January 2013 were removed from policyholder liabilities following its reclassification as held for sale at 31 December 2013. No further amounts are shown within the 2014 or 2013 analysis above in respect of Japan life business.

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

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

§ The policyholder liabilities of the with-profits business of £16,510 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,363 million to the Hong Kong with-profits business. Including this amount the Asia with-profits policyholder liabilities are £17,873 million.

Notes

(a) Movements in the year have been translated at the average exchange rates for the year ended 31 December 2014. The closing balance has been translated at the closing spot rates as at 31 December 2014. Differences upon retranslation are included in foreign exchange translation differences.

(b) Up until 31 December 2013 for the purposes of the presentation of unallocated surplus of with-profits within the statement of financial position, the Hong Kong branch balance was reported within the unallocated surplus of the PAC WPSF of the UK insurance operations.

On 1 January 2014, following consultation with the policyholders of PAC and regulators and court approval, the Hong Kong branch of PAC was transferred to separate subsidiaries established in Hong Kong. From this date the unallocated surplus of the Hong Kong with-profits business is reported within the Asia insurance operations segment.

(c) The policyholder liabilities of the Asia insurance operations of £38,705 million as shown in the table above is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,363 million to the Hong Kong with-profits business. Including this amount total Asia policyholder liabilities is £40,068 million.

(d) Net flows have increased by £546 million to £3,374 million in 2014 compared with £2,828 million in 2013 reflecting increased flows from new business and growth in the in-force books.

(e) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 10 per cent in 2014, in line with the 10 per cent recorded in 2013 (based on opening liabilities after the removal of Japan life). Maturities/deaths have increased from £997 million in 2013 to £1,259 million in 2014, primarily as a result of an increased number of endowment products within Malaysia and Singapore reaching their maturity point.

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(f) Investment-related items and other movements for 2014 principally represents unrealised gains on bonds, following the fall in bond yields and positive investment gains from the Asia equity market.

(g) The acquisition of Thanachart Life reflects the liabilities acquired at the date of acquisition.

(ii) Duration of liabilities

The table below shows the carrying value of policyholder liabilities and the maturity profile of the cash flows on a discounted basis for 2014 and 2013, taking account of expected future premiums and investment returns:

| | | 2014 | 2013 |
|--------------------------|----------------|--------|--------|
| | | £m | £m |
| Policyholder liabilities | | 38,705 | 31,910 |
| Expected maturity: | | % | % |
| | 0 to 5 years | 23 | 23 |
| | 5 to 10 years | 20 | 20 |
| | 10 to 15 years | 17 | 16 |
| | 15 to 20 years | 12 | 12 |
| | 20 to 25 years | 9 | 9 |
| | Over 25 years | 19 | 20 |

C4.1(c) US insurance operations

(i) Analysis of movements in policyholder liabilities

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

US insurance operations

| | Variable annuity separate account liabilities | Fixed annuity, GIC and other business | Total |
|-------------------------------------------------------|-----------------------------------------------|---------------------------------------|---------|
| | £m | £m | £m |
| At 1 January 2013 | 49,298 | 42,963 | 92,261 |
| Premiums | 11,377 | 4,574 | 15,951 |
| Surrenders | (2,906) | (2,181) | (5,087) |
| Maturities/Deaths | (485) | (744) | (1,229) |
| Net flows note (b) | 7,986 | 1,649 | 9,635 |
| Transfers from general to separate account | 1,603 | (1,603) | - |
| Investment-related items and other movements note (c) | 8,725 | (506) | 8,219 |
| Foreign exchange translation differences note (a) | (1,931) | (773) | (2,704) |
| At 31 December 2013 / 1 January 2014 | 65,681 | 41,730 | 107,411 |
| Premiums | 12,220 | 3,272 | 15,492 |
| Surrenders | (3,699) | (2,223) | (5,922) |
| Maturities/Deaths | (547) | (760) | (1,307) |
| Net flows note (b) | 7,974 | 289 | 8,263 |
| Transfers from general to separate account | 1,395 | (1,395) | - |
| Investment-related items and other movements note (c) | 1,963 | 1,749 | 3,712 |
| Foreign exchange translation differences note (a) | 4,728 | 2,632 | 7,360 |
| At 31 December 2014 | 81,741 | 45,005 | 126,746 |

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Average policyholder liability balances*

| | | | |
|------|--------|--------|---------|
| 2014 | 73,711 | 43,368 | 117,079 |
| 2013 | 57,489 | 42,347 | 99,836 |

* Averages have been based on opening and closing balances.

Notes

(a) Movements in the year have been translated at an average rate of US\$1.65/£1.00 (2013: US\$1.56/£1.00). The closing balances have been translated at closing rate of US\$1.56/£1.00 (2013: US\$1.66/£1.00). Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows for the year were £8,263 million compared with £9,635 million in 2013 on an actual exchange rate basis and £9,149 million on a constant exchange rate basis, reflecting in part lower premiums into the fixed index annuity business following product changes implemented in late 2013 to ensure appropriate returns on shareholder capital.

(c) Positive investment-related items and other movements in variable annuity separate account liabilities of £1,963 million for 2014 primarily reflects the increase in the US equity market during the year.

Fixed annuity, GIC and other business investment and other movements of £1,749 million primarily reflect the increase in interest credited to the policyholder accounts in the year and an increase in other guarantee reserves.

(ii) Duration of liabilities

The table below shows the carrying value of policyholder liabilities and maturity profile of the cash flows on a discounted basis for 2014 and 2013:

| | 2014 | | | 2013 | | |
|--------------------------|-------------------------------------------------------------------------------|------------------------|-------------|-------------------------------------------------------------------------------|------------------------|-------------|
| | Fixed annuity and other business (including GICs and similar contracts) £m | Variable annuity £m | Total £m | Fixed annuity and other business (including GICs and similar contracts) £m | Variable annuity £m | Total £m |
| Policyholder liabilities | 45,005 | 81,741 | 126,746 | 41,730 | 65,681 | 107,411 |
| | % | % | % | % | % | % |
| Expected maturity: | | | | | | |
| 0 to 5 years | 46 | 48 | 47 | 49 | 48 | 48 |
| 5 to 10 years | 27 | 29 | 29 | 27 | 31 | 30 |
| 10 to 15 years | 12 | 13 | 13 | 11 | 13 | 12 |
| 15 to 20 years | 7 | 6 | 6 | 6 | 5 | 5 |
| 20 to 25 years | 4 | 3 | 3 | 4 | 2 | 3 |
| Over 25 years | 4 | 1 | 2 | 3 | 1 | 2 |

C4.1(d) UK insurance operations

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

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

| | |
|-------------------------------------------|-------|
| Shareholder-backed funds and subsidiaries | |
| Annuity | Total |

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| | SAIF and PAC with-profits sub-fund £m | Unit-linked liabilities £m | and other long-term business £m | £m |
|--------------------------------------------------------------------------------------------|---------------------------------------------------|----------------------------------|------------------------------------------|---------|
| At 1 January 2013 | 94,933 | 22,197 | 27,308 | 144,438 |
| Comprising: | | | | |
| - Policyholder liabilities | 84,407 | 22,197 | 27,308 | 133,912 |
| - Unallocated surplus of with-profits funds | 10,526 | - | - | 10,526 |
| Premiums | 3,750 | 2,150 | 1,478 | 7,378 |
| Surrenders | (2,262) | (2,263) | (57) | (4,582) |
| Maturities/Deaths | (5,775) | (644) | (1,702) | (8,121) |
| Net flows note (b) | (4,287) | (757) | (281) | (5,325) |
| Shareholders' transfers post tax | (192) | - | - | (192) |
| Switches | (195) | 195 | - | - |
| Investment-related items and other movements | 5,695 | 2,017 | 100 | 7,812 |
| Foreign exchange translation differences | (117) | - | - | (117) |
| At 31 December 2013 / 1 January 2014 | 95,837 | 23,652 | 27,127 | 146,616 |
| Comprising: | | | | |
| - Policyholder liabilities | 83,853 | 23,652 | 27,127 | 134,632 |
| - Unallocated surplus of with-profits funds | 11,984 | - | - | 11,984 |
| Reallocation of unallocated surplus for the domestication of the Hong Kong branch note (a) | (1,690) | - | - | (1,690) |
| Premiums | 2,951 | 1,405 | 3,546 | 7,902 |
| Surrenders | (2,507) | (2,934) | (215) | (5,656) |
| Maturities/Deaths | (4,344) | (587) | (1,825) | (6,756) |
| Net flows note (b) | (3,900) | (2,116) | 1,506 | (4,510) |
| Shareholders' transfers post tax | (200) | - | - | (200) |
| Switches | (167) | 167 | - | - |
| Investment-related items and other movements note (c) | 9,637 | 1,597 | 3,076 | 14,310 |
| Foreign exchange translation differences | (90) | - | - | (90) |
| At 31 December 2014 | 99,427 | 23,300 | 31,709 | 154,436 |
| Comprising: | | | | |
| - Policyholder liabilities | 89,079 | 23,300 | 31,709 | 144,088 |
| - Unallocated surplus of with-profits funds | 10,348 | - | - | 10,348 |
| Average policyholder liability balances* | | | | |
| 2014 | 86,467 | 23,476 | 29,419 | 139,362 |
| 2013 | 84,130 | 22,924 | 27,218 | 134,272 |

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

Notes

(a) Up until 31 December 2013, for the purposes of the presentation of unallocated surplus of with-profits within the statement of financial position, the Hong Kong branch balance was reported within the unallocated surplus of the PAC WPSF of the UK insurance operations.

On 1 January 2014, following consultation with the policyholders of PAC and regulators and court approval, the Hong Kong branch of PAC was transferred to separate subsidiaries established in Hong Kong. From this date the unallocated surplus of the Hong Kong with-profits business is reported within the Asia insurance operations segment.

(b) Net outflows improved from £5,325 million in 2013 to £4,510 million in 2014, due primarily to higher premium flows (up £2,068 million to £3,546 million) into our annuity and other long-term business following an increase in the number of bulk annuity transaction in the year. The levels of inflows/outflows for unit-linked business is driven by

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corporate pension schemes with transfers in or out from only a small number of schemes influencing the level of flows in the year.

(c) Investment-related items and other movements of £14,310 million reflect both growth in equity markets and fall in long-term bond yields in 2014.

(ii) Duration of liabilities

The tables above show the carrying value of the policyholder liabilities and the maturity profile of the cash flows for insurance contracts, as defined by IFRS:

| | With-profits business | | | 2014 £m Annuity business (Insurance contracts) | | | Other | Total | | |
|--------------------------|-----------------------|----------------------|--------|------------------------------------------------------|--------|--------|--------|---------------------|----------------------|---------|
| | Insurance contracts | Investment contracts | Total | Non-profit annuities within WPSF (including PAL) | | | | Insurance contracts | Investment contracts | Total |
| | | | | PRIL | Total | Total | | | | |
| | 2014 % | | | | | | | | | |
| Policyholder liabilities | 38,287 | 39,084 | 77,371 | 11,708 | 22,186 | 33,894 | 15,474 | 17,349 | 32,823 | 144,088 |

Expected maturity:

| | | | | | | | | | | |
|----------------|----|----|----|----|----|----|----|----|----|----|
| 0 to 5 years | 40 | 39 | 39 | 31 | 25 | 27 | 37 | 36 | 36 | 36 |
| 5 to 10 years | 24 | 26 | 25 | 25 | 22 | 23 | 25 | 22 | 24 | 24 |
| 10 to 15 years | 14 | 17 | 16 | 18 | 18 | 18 | 16 | 16 | 16 | 17 |
| 15 to 20 years | 9 | 11 | 10 | 11 | 14 | 13 | 10 | 11 | 11 | 11 |
| 20 to 25 years | 6 | 5 | 5 | 7 | 9 | 9 | 5 | 8 | 6 | 6 |
| over 25 years | 7 | 2 | 5 | 8 | 12 | 10 | 7 | 7 | 7 | 6 |

| | 2013 £m | | | 2013 % | | | | | | |
|--------------------------|---------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Policyholder liabilities | 36,248 | 35,375 | 71,623 | 12,230 | 19,973 | 32,203 | 13,223 | 17,583 | 30,806 | 134,632 |

Expected maturity:

| | | | | | | | | | | |
|----------------|----|----|----|----|----|----|----|----|----|----|
| 0 to 5 years | 42 | 40 | 41 | 33 | 28 | 30 | 39 | 40 | 39 | 38 |
| 5 to 10 years | 24 | 25 | 25 | 25 | 23 | 24 | 25 | 22 | 23 | 24 |
| 10 to 15 years | 14 | 17 | 16 | 18 | 18 | 18 | 16 | 16 | 16 | 16 |
| 15 to 20 years | 9 | 11 | 10 | 11 | 13 | 12 | 9 | 10 | 10 | 11 |
| 20 to 25 years | 5 | 5 | 5 | 6 | 8 | 8 | 5 | 6 | 6 | 6 |
| over 25 years | 6 | 2 | 3 | 7 | 10 | 8 | 6 | 6 | 6 | 5 |

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

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

(iii) Investment contracts under 'Other' comprise certain unit-linked and similar contracts accounted for under IAS 39 and IAS 18.

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

(v) The maturity tables shown above have been prepared on a discounted basis.

C5 Intangible assets

C5.1 Intangible assets attributable to shareholders

(a) Goodwill attributable to shareholders

| | 2014 £m | 2013 £m |
|--------------------------------|---------|---------|
| Cost | | |
| At beginning of year | 1,581 | 1,589 |
| Exchange differences | 2 | (8) |
| At end of year | 1,583 | 1,581 |
| Aggregate impairment | (120) | (120) |
| Net book amount at end of year | 1,463 | 1,461 |

Goodwill attributable to shareholders comprises:

| | 2014 £m | 2013 £m |
|-------|---------|---------|
| M&G | 1,153 | 1,153 |
| Other | 310 | 308 |
| | 1,463 | 1,461 |

Other goodwill represents amounts allocated to entities in Asia and the US operations. These goodwill amounts by acquired operations are not individually material.

The aggregate goodwill impairment of £120 million at 31 December 2014 and 2013 relates to the goodwill held in relation to the held for sale Japan Life business (see note D1), which was impaired in 2005.

(b) Deferred acquisition costs and other intangible assets attributable to shareholders

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

| | 2014 £m | 2013 £m |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|---------|
| Deferred acquisition costs related to insurance contracts as classified under IFRS 4 | 5,840 | 4,684 |
| Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 | 87 | 96 |
| | 5,927 | 4,780 |
| Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF) | 59 | 67 |
| Distribution rights and other intangibles | 1,275 | 448 |
| | 1,334 | 515 |
| Total of deferred acquisition costs and other intangible assets | 7,261 | 5,295 |

| | 2014 £m | | | | 2013 £m | | |
|----------------------|----------------------------|-------|---------------|-------|-----------------------------|-------|-------|
| | Deferred acquisition costs | | | | | | |
| | Asia | US | UK management | Asset | PVIF and other intangibles† | Total | Total |
| Balance at 1 January | 553 | 4,121 | 89 | 17 | 515 | 5,295 | 4,177 |

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| | | | | | | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|------|-----|-------|-------|-------|
| Reclassification of Japan Life as held for salenote D1 | - | - | - | - | - | - | (28) |
| Additions and acquisitions of subsidiaries | 209 | 678 | 8 | 8 | 865 | 1,768 | 1,251 |
| Amortisation to the income statement: | | | | | | | |
| Operating profit | (128) | (487) | (14) | (8) | (59) | (696) | (643) |
| Non-operating profit | - | 653 | - | - | - | 653 | 228 |
| | (128) | 166 | (14) | (8) | (59) | (43) | (415) |
| Disposals | - | - | - | - | (6) | (6) | (1) |
| Exchange differences and other movements | 16 | 299 | - | - | 19 | 334 | (187) |
| Amortisation of DAC related to net unrealised valuation movements on Jackson's available-for-sale securities recognised within other comprehensive income | - | (87) | - | - | - | (87) | 498 |
| Balance at 31 December | 650 | 5,177 | 83 | 17 | 1,334 | 7,261 | 5,295 |

†

PVIF and other intangibles includes software rights of £66 million (2013: £56 million) with additions of £34 million, amortisation of £25 million and exchange losses of £1 million.

Note

PVIF and other intangibles comprise PVIF, distribution rights and other intangibles such as software rights. Distribution rights relate to amounts that have been paid or have become unconditionally due for payment as a result of past events in respect of bancassurance partnership arrangements in Asia. These agreements allow for bank distribution of Prudential's insurance products for a fixed period of time. Additions of £865 million in 2014 principally relate to fees paid and due to extend the term and expand the geographic scope of the agreement with Standard Chartered Bank and other fees on current distribution deals.

It also includes £18 million for PVIF and other intangibles in 2014 for the acquisition of Express Life of Ghana and Shield Assurance Company Limited in Kenya.

US insurance operations

Summary balances

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

| | 2014 £m | 2013 £m |
|------------------------------------------------------------------------------------|---------|---------|
| Variable annuity business | 5,002 | 3,716 |
| Other business | 759 | 868 |
| Cumulative shadow DAC (for unrealised gains booked in other comprehensive income)* | (584) | (463) |
| Total DAC for US operations | 5,177 | 4,121 |

* Consequent upon the positive unrealised valuation movement in 2014 of £956 million (2013: negative unrealised valuation movement of £2,089 million), there is a charge of £87 million (2013: a credit of £498 million) for altered 'shadow' DAC amortisation booked within other comprehensive income. These adjustments reflect movement from period to period, in the changes to the pattern of reported gross profits that would have happened if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 31 December 2014, the cumulative shadow DAC balance as shown in the table above was negative £584 million (2013: negative £463 million).

Overview of the deferral and amortisation of acquisition costs for Jackson

Under IFRS 4, the Group applies 'grandfathered' US GAAP for measuring the insurance assets and liabilities of Jackson.

In the case of Jackson term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest-sensitive life business, acquisition costs are deferred and amortised in line with a combination of historical and future expected gross profits on the relevant contracts. For fixed interest rate and fixed index annuity and interest-sensitive life business, the key assumption is the long-term spread between the earned rate on investments and the rate credited to policyholders, which is based on an annual spread analysis. Expected gross profits also depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all of which are based on a combination of actual experience of Jackson, industry experience and future expectations. A detailed analysis of actual mortality, lapse and expense experience is performed using internally developed experience studies.

Acquisition costs for Jackson's variable annuity products are also amortised in line with the emergence of profits. The measurement of the amortisation in part reflects current period fees (including those for guaranteed minimum death, income, or withdrawal benefits) earned on assets covering liabilities to policyholders, and the historical and expected level of future gross profits which depends on the assumed level of future fees, as well as components related to mortality, lapse, expense and the long-term cost of hedging.

Mean reversion technique

For variable annuity products, under US GAAP (as 'grandfathered' under IFRS 4) the projected gross profits, against which acquisition costs are amortised, reflect an assumed long-term level of returns on separate account investments which, as referenced in note A3, for Jackson, is 7.4 per cent (2013: 7.4 per cent) after deduction of net external fund management fees. This is applied to the period end level of separate account assets after application of a mean reversion technique that removes a portion of the effect of levels of short-term variability in current market returns.

Under the mean reversion technique applied by Jackson, the projected level of return for each of the next five years is adjusted from period to period so that in combination with the actual rates of return for the preceding two years and the current period, the 7.4 per cent (2013: 7.4 per cent) annual return is realised on average over the entire eight-year period. Projected returns after the mean reversion period revert back to the 7.4 per cent (2013: 7.4 per cent) assumption.

However, to ensure that the methodology does not over anticipate a reversion to the long-term level of returns following adverse markets, the mean reversion technique has a cap and floor feature whereby the projected returns in each of the next five years can be no more than 15 per cent per annum and no less than 0 per cent per annum (after deduction of net fund management fees) in each year.

Sensitivity of amortisation charge

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

- i) A core amount that reflects a relatively stable proportion of underlying premiums or profit; and
- ii) An element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

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

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In 2014, the DAC amortisation charge for operating profit was determined after including a charge for accelerated amortisation of £13 million (2013: credit for decelerated amortisation of £82 million). The 2014 amount primarily reflects

the separate account performance of 6 per cent, which is lower than the assumed level for the year.

As noted above, the application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation while the mean reversion assumption lies within the corridor. It would take a significant movement in equity markets in 2015 (outside the range of negative 34 per cent to positive 36 per cent) for the mean reversion assumption to move outside the corridor.

C6 Borrowings

C6.1 Core structural borrowings of shareholder-financed operations

| | 2014 | 2013 |
|----------------------------------------------------------------------------------|-------|-------|
| | £m | £m |
| Holding company operations: | | |
| Perpetual Subordinated Capital Securities (Innovative Tier 1) note (i),(iv),(vI) | 1,789 | 2,133 |
| Subordinated Notes (Lower Tier 2) note (i),(v) | 1,531 | 1,529 |
| Subordinated debt total | 3,320 | 3,662 |
| Senior debt: note (ii) | | |
| £300m 6.875% Bonds 2023 | 300 | 300 |
| £250m 5.875% Bonds 2029 | 249 | 249 |
| Holding company total | 3,869 | 4,211 |
| Prudential Capital bank loan note (iii) | 275 | 275 |
| Jackson US\$250m 8.15% Surplus Notes 2027 (Lower Tier 2) | 160 | 150 |
| Total (per consolidated statement of financial position) | 4,304 | 4,636 |

Notes

(i) These debt classifications are consistent with the treatment of capital for regulatory purposes, as defined in the Prudential Regulation Authority handbook.

Tier 1 subordinated debt is entirely US\$ denominated.

The Group has designated all US\$2.80 billion (2013: US\$3.55 billion) of its Tier 1 subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.

(ii) The senior debt ranks above subordinated debt in the event of liquidation.

(iii) The Prudential Capital bank loan of £275 million has been made in two tranches: a £160 million loan maturing on 20 December 2017 and a £115 million loan also maturing on 20 December 2017. These two tranches are currently drawn at a cost of 12 month £LIBOR plus 0.40 per cent.

(iv) In January 2013, the Company issued core structural borrowings of US\$700 million 5.25 per cent Tier 1 Perpetual Subordinated Capital Securities primarily to retail investors in Asia. The proceeds, net of costs, were US\$689 million.

(v) In December 2013, the Company issued core structural borrowings of £700 million Lower Tier 2 Subordinated Notes primarily to UK institutional investors. The proceeds, net of costs, were £695 million.

(vi) On 23 December 2014, the Company exercised its right to redeem early the US\$750 million 11.75 per cent Tier 1 perpetual subordinated capital securities at their aggregate nominal amount together with accrued interest.

C6.2 Other borrowings

(a) Operational borrowings attributable to shareholder-financed operations

| | 2014 £m | 2013 £m |
|------------------------------------------------------------------------|---------|---------|
| Borrowings in respect of short-term fixed income securities programmes | 2,004 | 1,933 |
| Non-recourse borrowings of US operations | 19 | 18 |
| Other borrowings note (ii) | 240 | 201 |
| Totalnote (i) | 2,263 | 2,152 |

Notes

(i) In addition to the debt listed above, £200 million Floating Rate Notes were issued by Prudential plc in October 2014 which will mature in October 2015. These Notes have been wholly subscribed to a Group subsidiary and accordingly have been eliminated on consolidation in the Group financial statements. These Notes were originally issued in October 2008 and have been reissued upon their maturity.

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

(iii) In January 2015, the Company issued £300 million Medium Term Notes which will mature in January 2018. The proceeds, net of costs, were £299 million.

(b) Borrowings attributable to with-profits operations

| | 2014 £m | 2013 £m |
|------------------------------------------------------------------------------------|---------|---------|
| Non-recourse borrowings of consolidated investment funds | 924 | 691 |
| £100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc* | 100 | 100 |
| Other borrowings (predominantly obligations under finance leases) | 69 | 104 |
| Total | 1,093 | 895 |

* The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinated to the entitlements of the policyholders of that fund.

C7 Risk and sensitivity analysis

C7.1 Group overview

The Group's risk framework and the management of the risk including those attached to the Group's financial statements including financial assets, financial liabilities and insurance liabilities, together with the inter-relationship with the management of capital have been included in the audited sections of 'Group Chief Risk Officer's report on the risks facing our business and our capital strength'.

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

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

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| Type of business | Market and credit risk | | Insurance and lapse risk |
|---------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|
| | Investments/derivatives | Other exposure | |
| Asia insurance operations (see also section C7.2) | | | Mortality and morbidity risk Persistency risk |
| All business | | Currency risk | |
| With-profits business | Net neutral direct exposure (Indirect exposure only) | | Investment performance subject to smoothing through declared bonuses |
| Unit-linked business | Net neutral direct exposure (Indirect exposure only) | | Investment performance through asset management fees |
| Non-participating business | | Asset/liability mismatch risk Interest rates for those operations where the basis of insurance liabilities is sensitive to current market movements | |
| | Credit risk | | |
| | Interest rate and price risk | | |
| US insurance operations (see also section C7.3) | | | Persistency risk |
| All business | | Currency risk | |
| Variable annuity business | Net effect of market risk arising from incidence of guarantee features and variability of asset management fees offset by derivative hedging programme | | |
| Fixed index annuity business | Derivative hedge programme to the extent not fully hedged against liability | Incidence of equity participation features | |
| Fixed index annuities, Fixed annuities and GIC business | Credit risk Interest rate risk Profit and loss and shareholders' equity are | | Spread difference between earned rate and rate credited to policyholders |
| | | | Lapse risk, but the effects of extreme events are mitigated |

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

by the application of market value adjustments

UK insurance operations (see also section C7.4)

With-profits business

Net neutral direct exposure (Indirect exposure only)

Investment performance subject to smoothing through declared bonuses

Persistency risk to future shareholder transfers

SAIF sub-fund

Net neutral direct exposure (Indirect exposure only)

Asset management fees earned by M&G

Unit-linked business

Net neutral direct exposure (Indirect exposure only)

Investment performance through asset management fees

Persistency risk

Asset/liability mismatch risk

Shareholder-backed annuity business

Credit risk for assets covering liabilities and shareholder capital

Interest rate risk for assets in excess of liabilities ie assets representing shareholder capital

Mortality experience and assumptions for longevity

Detailed analyses of sensitivity of IFRS basis profit or loss and shareholders' equity to key market and other risks by business unit are provided in notes C7.2, C7.3, C7.4 and C7.5. The sensitivity analyses provided show the effect on

profit or loss and shareholders' equity to changes in the relevant risk variables, all of which are reasonably possible at the relevant balance sheet date.

In the equity risk sensitivity analysis shown below, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put mitigating management actions in place. In addition, the equity risk sensitivity analysis provided assumed that all equity indices fall by the same percentage.

Impact of diversification on risk exposure

The Group enjoys significant diversification benefits achieved through the geographical spread of the Group's operations and, within those operations through a broad mix of products types. This arises because not all risk scenarios are likely to happen at the same time and across all geographic regions. Relevant correlation factors include:

Correlation across geographic regions:

- Financial risk factors; and
- Non-financial risk factors.

Correlation across risk factors:

- Longevity risk;
- Expenses;
- Persistency; and
- Other risks.

The effect of Group diversification across the Group's life businesses is to significantly reduce the aggregate standalone volatility risk to IFRS operating profit based on longer-term investment returns. The effect is almost wholly explained by the correlations across risk types, in particular mortality and longevity risk.

C7.2 Asia insurance operations

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

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

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

In summary, for Asia operations, the operating profit based on longer-term investment returns is mainly affected by the impact of market levels on unit-linked persistency, and other insurance risks. At the total IFRS profit level the Asia result is affected by short-term value movements on the asset portfolio for non-linked shareholder-backed business.

(i) Sensitivity to risks other than foreign exchange risk

With-profits business

Similar principles to those explained for UK with-profits business in C7.4 apply to profit emergence for the Asia with-profits business. Correspondingly, the profit emergence reflects bonus declaration and is relatively insensitive to period by period fluctuations in insurance risk or interest rate movements.

Unit-linked business

As for the UK insurance operations, for unit-linked business, the main factor affecting the profit and shareholders' equity of the Asia operations is investment performance through asset management fees. The sensitivity of profits and shareholders' equity to changes in insurance risk, interest rate risk and credit risk are not material.

Other business

Interest rate risk

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

For the purposes of analysing sensitivity to variations in interest rates, reference has been made to the movements in the 10-year government bond rates of the territories. At 31 December 2014, 10-year government bond rates vary from territory to territory and range from 1.6 per cent to 8.0 per cent (2013: 1.7 per cent to 9.0 per cent).

For the sensitivity analysis as shown in the table below, the reasonably possible interest rate movement used is one per cent for all territories but subject to a floor of zero where the bond rates are currently below 1 per cent.

The estimated sensitivity to the decrease and increase in interest rates at 31 December 2014 and 2013 is as follows:

| | 2014 £m | | 2013 £m | |
|------------------------------------------------|-------------------|-------------------|-------------------|-------------------|
| | Decrease of 1% | Increase of 1% | Decrease of 1% | Increase of 1% |
| Profit before tax attributable to shareholders | (54) | (137) | 311 | (215) |
| Related deferred tax (where applicable) | (5) | 24 | (34) | 40 |
| Net effect on profit and shareholders' equity | (59) | (113) | 277 | (175) |

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

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

In addition, the degree of sensitivity of the results shown in the table above is dependent on the interest rate level at that point of time. In 2014, the lower interest rates in certain countries have had an adverse impact on the degree of sensitivity to a decrease in interest rates.

Equity price risk

The non-linked shareholder business has limited exposure to equity and property investment (31 December 2014: £932 million). Generally changes in equity and property investment values are not directly offset by movements in policyholder liabilities.

The estimated sensitivity to a 10 per cent and 20 per cent change in equity and property prices for shareholder-backed Asia other business, which would be reflected in the short-term fluctuation component of the Group's segmental analysis of profit before tax, at 31 December 2014 and 2013 would be as follows:

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| | 2014 £m | | 2013 £m | |
|------------------------------------------------|----------|--------|----------|--------|
| | Decrease | | Decrease | |
| | of 20% | of 10% | of 20% | of 10% |
| Profit before tax attributable to shareholders | (187) | (93) | (114) | (57) |
| Related deferred tax (where applicable) | 23 | 11 | 24 | 12 |
| Net effect on profit and shareholders' equity | (164) | (82) | (90) | (45) |

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

Insurance risk

Many of the territories in Asia are exposed to mortality/morbidity risk and provision is made within policyholder liabilities on a prudent regulatory basis to cover the potential exposure. If these prudent assumptions were strengthened by 5 per cent then it is estimated that post tax profit and shareholders' equity would be decreased by approximately £47 million (2013: £38 million). Mortality and morbidity has a symmetrical effect on the portfolio and any weakening of these assumptions would have a similar equal and opposite impact.

(ii) Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Asia insurance operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2014, the rates for the most significant operations are given in note A1.

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

| | A 10% increase in local currency to £ exchange rates | | A 10% decrease in local currency to £ exchange rates | |
|------------------------------------------------------------------------------|---------------------------------------------------------|---------|---------------------------------------------------------|---------|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Profit before tax attributable to shareholders | (111) | (63) | 135 | 77 |
| Profit for the year | (95) | (49) | 117 | 60 |
| Shareholders' equity, excluding goodwill, attributable to Asia operations | (315) | (246) | 384 | 300 |

C7.3 US insurance operations

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

At the level of operating profit based on longer-term investment returns, Jackson's results are sensitive to market conditions to the extent of income earned on spread-based products and indirectly in respect of variable annuity asset management fees.

Jackson's main exposures are to market risk through its exposure to interest rate risk and equity risk. Approximately 94 per cent (2013: 94 per cent) of its general account investments support fixed interest rate and fixed index annuities, life business and surplus and 6 per cent (2013: 6 per cent) support institutional businesses. All of these types of business contain considerable interest rate guarantee features and, consequently, require that the assets that support them are primarily fixed income or fixed maturity.

Jackson is exposed primarily to the following risks:

| | |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Risks | Risk of loss |
| | <ul style="list-style-type: none"> • related to the incidence of benefits related to guarantees issued in connection with its variable annuity contracts; and |
| Equity risk | <ul style="list-style-type: none"> • related to meeting contractual accumulation requirements in fixed index annuity contracts. • related to meeting guaranteed rates of accumulation on fixed annuity products |
| Interest rate risk | <p>following a sharp and sustained fall in interest rates;</p> <ul style="list-style-type: none"> • related to the guarantee features attached to the company's products and to policyholder withdrawals following a sharp and sustained increase in interest rates; and • the risk of mismatch between the expected duration of certain annuity liabilities and prepayment risk and extension risk inherent in mortgage-backed securities. |

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

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

Jackson uses free-standing derivative instruments for hedging purposes. Additionally, certain liabilities, primarily trust instruments supported by funding agreements, fixed index annuities, certain Guaranteed Minimum Withdrawal Benefit variable annuity features and reinsured Guaranteed Minimum Income Benefit variable annuity features contain embedded derivatives as defined by IAS 39, 'Financial Instruments: Recognition and Measurement'. Jackson does not account for such derivatives as either fair value or cash flow hedges as might be permitted if the specific hedge documentation requirements of IAS 39 were followed. Financial derivatives, including derivatives embedded in certain host liabilities that have been separated for accounting and financial reporting purposes are carried at fair value.

Value movements on the derivatives are reported within the income statement. In preparing Jackson's segment profit as shown in note B1.1 value movements on Jackson's derivative contracts, are included within short-term fluctuations in investment returns and excluded from operating results based on longer-term investment returns.

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

| Derivative | Purpose |
|---------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Interest rate swaps | <p>These generally involve the exchange of fixed and floating payments over the period for which Jackson holds the instrument without an exchange of the underlying principal amount. These agreements are used for hedging purposes.</p> |

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| | |
|---------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Put-swaption contracts | These contracts provide the purchaser with the right, but not the obligation, to require the writer to pay the present value of a long-duration interest rate swap at future exercise dates. Jackson purchases and writes put-swaptions with maturities up to 5 years. Put-swaptions hedge against significant movements in interest rates. |
| Equity index futures contracts and equity index options | These derivatives (including various call and put options and interest rate contingent options) are used to hedge Jackson's obligations associated with its issuance of fixed index deferred annuities and certain VA guarantees. Some of these annuities and guarantees contain embedded options which are fair valued for financial reporting purposes. Total return swaps in which Jackson receives equity returns or returns based on reference pools of assets in exchange for short-term floating rate payments based on notional amounts, are held for both hedging and investment purposes. |
| Total return swaps | Cross-currency swaps, which embody spot and forward currency swaps and additionally, in some cases, interest rate swaps and equity index swaps, are entered into for the purpose of hedging Jackson's foreign currency denominated funding agreements supporting trust instrument obligations. |
| Cross-currency swaps | These swaps, represent agreements under which Jackson has purchased default protection on certain underlying corporate bonds held in its portfolio. These contracts allow Jackson to sell the protected bonds at par value to the counterparty if a default event occurs in exchange for periodic payments made by Jackson for the life of the agreement. Jackson does not write default protection using credit derivatives. |
| Credit default swaps | |

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

(i) Sensitivity to equity risk

At 31 December 2014 and 2013, Jackson had variable annuity contracts with guarantees, for which the net amount at risk ('NAR') is defined as the amount of guaranteed benefit in excess of current account value, as follows:

| | | Minimum return | Account value £m | Net amount at risk £m | Weighted average attained age | Period until expected annuitisation |
|------------------|------------------------------------------------------------------------------------------------------------------------------|----------------|---------------------|--------------------------|-------------------------------|-------------------------------------|
| 31 December 2014 | | | | | | |
| | Return of net deposits plus a minimum return | | | | | |
| | GMDB | 0-6% | 64,344 | 1,463 | 65.0 | years |
| | GMWB - Premium only | 0% | 2,151 | 32 | | |
| | | 0-5% | | | | |
| | GMWB* | ** | 264 | 17 | | |
| | GMAB - Premium only | 0% | 53 | - | | |
| | Highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| | | | | | 65.0 | |
| | GMDB | | 6,581 | 193 | years | |
| | GMWB - Highest anniversary only | | 2,131 | 85 | | |
| | GMWB* | | 830 | 58 | | |
| | Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary | | | | | |

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| | | Minimum return | Account value £m | Net amount at risk £m | Weighted average age annuitisation | Period until expected |
|------------------------------------------------------------------------------------------------------------------------------|--|----------------|---------------------|-----------------------------|---------------------------------------------|-----------------------------|
| | | | | | 67.5 years | |
| GMDB | | 0-6% | 3,978 | 302 | | |
| GMIB† | | 0-6% | 1,595 | 360 | | 1.4 years |
| GMWB* | | 0-8% ** | 57,323 | 2,033 | | |
| 31 December 2013 | | | | | | |
| Return of net deposits plus a minimum return | | | | | | |
| | | | | | 64.7 years | |
| GMDB | | 0-6% | 52,985 | 1,248 | | |
| GMWB - Premium only | | 0% 0-5% | 2,260 | 36 | | |
| GMWB* | | ** | 289 | 18 | | |
| GMAB - Premium only | | 0% | 57 | - | | |
| Highest specified anniversary account value minus withdrawals post-anniversary | | | | | | |
| | | | | | 64.6 years | |
| GMDB | | | 5,522 | 134 | | |
| GMWB - Highest anniversary only | | | 2,039 | 93 | | |
| GMWB* | | | 875 | 63 | | |
| Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary | | | | | | |
| | | | | | 66.9 years | |
| GMDB | | 0-6% | 3,522 | 217 | | |
| GMIB† | | 0-6% | 1,642 | 317 | | 2.4 years |
| GMWB* | | 0-8% ** | 46,091 | 1,087 | | |

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

** Ranges shown based on simple interest. The upper limits of 5 per cent, or 8 per cent simple interest are approximately equal to 4.1 per cent and 6 per cent respectively, on a compound interest basis over a typical ten year bonus period. For example $1 + 10 \times 0.05$ is similar to 1.041 growing at a compound rate of 4.01 per cent for a further nine years.

† The GMIB reinsurance guarantees are essentially fully reinsured

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

| | | 2014 £m | 2013 £m |
|-------------------|--|---------|---------|
| Mutual fund type: | | | |
| Equity | | 50,071 | 40,529 |
| Bond | | 11,139 | 10,043 |

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| | | |
|--------------|--------|--------|
| Balanced | 12,901 | 10,797 |
| Money market | 675 | 703 |
| Total | 74,786 | 62,072 |

As noted above, Jackson is exposed to equity risk through the options embedded in the fixed index annuity liabilities and Guaranteed Minimum Death Benefit and Guaranteed Minimum Withdrawal Benefit guarantees included in certain variable annuity benefits as illustrated above. This risk is managed using an equity hedging programme to minimise the risk of a significant economic impact as a result of increases or decreases in equity market levels while taking advantage of naturally offsetting exposures in Jackson's operations. Jackson purchases external futures and options that hedge the risks inherent in these products, while also considering the impact of rising and falling separate account fees.

As a result of this hedging programme, if the equity markets were to increase further in the future, the net effect of Jackson's free-standing derivatives would decrease in value. However, over time, this movement would be broadly offset by increased separate account fees and reserve decreases, net of the related changes to amortisation of deferred acquisition costs. Due to the nature of the free-standing and embedded derivatives, this hedge, while highly effective on an economic basis, may not completely mute in the financial reporting the immediate impact of equity market movements as the free-standing derivatives reset immediately while the hedged liabilities reset more slowly and fees are recognised prospectively. The opposite impact would be observed if the equity markets were to decrease.

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

At 31 December 2014, the estimated sensitivity of Jackson's profit and shareholders' equity to immediate increases and decreases in equity markets is shown below. The sensitivities are shown net of related changes in DAC amortisation.

| | 2014 £m | | | | 2013 £m | | | |
|---------------------------------------------------------------|----------|--------|----------|--------|----------|--------|----------|--------|
| | Decrease | | Increase | | Decrease | | Increase | |
| | of 20% | of 10% | of 20% | of 10% | of 20% | of 10% | of 20% | of 10% |
| Pre-tax profit, net of related changes in amortisation of DAC | 360 | 130 | 8 | (25) | 485 | 165 | 213 | 77 |
| Related deferred tax effects | (126) | (46) | (3) | 9 | (170) | (58) | (74) | (27) |
| Net sensitivity of profit after tax and shareholders' equity | 234 | 84 | 5 | (16) | 315 | 107 | 139 | 50 |

Note

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

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

The directional movements in the sensitivities reflect the hedging programme in place at 31 December 2014 and 2013.

(ii) Sensitivity to interest rate risk

Notwithstanding the market risk exposure previously described, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets

held to cover liabilities, the accounting measurement of fixed annuity liabilities of Jackson products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement. The Guaranteed Minimum Withdrawal Benefit features attached to variable annuity business (other than 'for-life') are accounted for as embedded derivatives which are fair valued and so will be sensitive to changes in interest rate.

Debt securities and related derivatives are marked to fair value. Value movements on derivatives, again net of related changes to amortisation of DAC and deferred tax, are recorded within the income statement. Fair value movements on debt securities, net of related changes to amortisation of DAC and deferred tax, are recorded within other comprehensive income. The estimated sensitivity of these items and policyholder liabilities to a 1 per cent and 2 per cent decrease (subject to a floor of zero) and increase in interest rates at 31 December 2014 and 2013 is as follows:

| | 2014 £m | | | | 2013 £m | | | |
|----------------------------------------------------------------------------------------------------|-------------------------|-------|-------------------------|---------|-------------------------|-------|-------------------------|---------|
| | Decrease of 2% of 1% | | Increase of 1% of 2% | | Decrease of 2% of 1% | | Increase of 1% of 2% | |
| Profit and loss: | | | | | | | | |
| Pre-tax profit effect (net of related changes in amortisation of DAC) | (1,398) | (690) | 494 | 875 | (128) | (66) | (52) | (161) |
| Related effect on charge for deferred tax | 489 | 242 | (173) | (306) | 45 | 23 | 18 | 56 |
| Net profit effect | (909) | (448) | 321 | 569 | (83) | (43) | (34) | (105) |
| Other comprehensive income: | | | | | | | | |
| Direct effect on carrying value of debt securities (net of related changes in amortisation of DAC) | 2,979 | 1,663 | (1,663) | (2,979) | 2,624 | 1,477 | (1,477) | (2,624) |
| Related effect on movement in deferred tax | (1,043) | (582) | 582 | 1,043 | (918) | (517) | 517 | 918 |
| Net effect | 1,936 | 1,081 | (1,081) | (1,936) | 1,706 | 960 | (960) | (1,706) |
| Total net effect on shareholders' equity | 1,027 | 633 | (760) | (1,367) | 1,623 | 917 | (994) | (1,811) |

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

(iii) Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Group's US operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2014, the average and closing rates were US\$1.65 (2013: \$1.56) and US\$1.56 (2013: US\$1.66) to £1.00 sterling, respectively. A 10 per cent increase (weakening of the dollar) or decrease (strengthening of the dollar) in these rates would reduce or increase profit before tax attributable to shareholders, profit for the year and shareholders' equity attributable to US insurance operations respectively as follows:

| | A 10% increase in US\$:£ exchange rates | | A 10% decrease in US\$:£ exchange rates | |
|--------------------------------------------------------------|--------------------------------------------|---------|--------------------------------------------|---------|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Profit before tax attributable to shareholders note | (23) | (50) | 29 | 61 |
| Profit for the year | (23) | (41) | 28 | 50 |
| Shareholders' equity attributable to US insurance operations | (370) | (313) | 452 | 383 |

Note:

Sensitivity on profit (loss) before tax is aggregate of the operating profit based on longer-term investment returns and short-term fluctuations in investment returns.

(iv) Other sensitivities

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

As with other shareholder-backed business the profit or loss for Jackson is presented by distinguishing the result for the year between an operating result based on longer-term investment returns and short-term fluctuations in investment returns. In this way the most significant direct effect of market changes that have taken place to the Jackson result are separately identified. The principal determinants of variations in operating profit based on longer-term returns are:

- Growth in the size of assets under management covering the liabilities for the contracts in force;
- Variations in fees and other income, offset by variations in market value adjustment payments and, where necessary, strengthening of liabilities;
- Spread returns for the difference between investment returns and rates credited to policyholders; and
- Amortisation of deferred acquisition costs.

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest sensitive life business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders, which is based on an annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges) all of which are based on a combination of actual experience of Jackson, industry experience and future expectations. A detailed analysis of actual experience is measured by internally developed expense, mortality and persistency studies.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and Guaranteed Minimum Death Benefit reserves, the profits of Jackson are relatively insensitive to changes in insurance risk.

Jackson is sensitive to lapse risk and other types of policyholder behaviour, such as the take-up of its Guaranteed Minimum Withdrawal Benefit product features. Jackson has extensive derivative programme to seek to manage the exposure for altered equity markets and interest rates. For example, Jackson uses derivatives to ameliorate the effect of a sharp rise in interest rates, which would be the most likely cause of a sudden change in policyholder behaviour.

For variable annuity business, the key assumption is the expected long-term level of separate account returns, which for 2014 was 7.4 per cent (2013: 7.4 per cent). The impact of using this return is reflected in two principal ways, namely:

- Through the projected expected gross profits which are used to determine the amortisation of deferred acquisition costs. This is applied through the use of a mean reversion technique which is described in more detail in note C5.1(b) above; and
- The required level of provision for guaranteed minimum death benefit claims.

C7.4 UK insurance operations

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

The IFRS basis results of the UK insurance operations are most sensitive to asset/liability matching, mortality and default rate experience and longevity assumptions and the difference between the return on corporate bond and risk-free rate for shareholder-backed annuity business of Prudential Retirement Income Limited and the Prudential Assurance Company non-profit sub-fund. Further details are described below.

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

With-profits business

SAIF

Shareholders have no interest in the profits of the ring-fenced fund of SAIF but are entitled to the asset management fees paid on the assets of the fund.

With-profits sub-fund business

The shareholder results of the UK with-profits business (including non-participating annuity business of the with-profits sub-fund

are only sensitive to market risk through the indirect effect of investment performance on declared policyholder bonuses.

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

The shareholder results of the UK with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business which is currently one-ninth of the cost of bonuses declared. Investment performance is a key driver of bonuses, and hence the shareholders' share of the cost of bonuses. Due to the 'smoothed' basis of bonus declaration, the sensitivity to investment performance in a single year is low relative to movements in the period to period performance. However, over multiple periods, it is important.

Mortality and other insurance risk are relatively minor factors in the determination of the bonus rates. Adverse persistency experience can affect the level of profitability from with-profits but in any given one year, the shareholders' share of cost of bonus may only be marginally affected. However, altered persistency trends may affect future expected shareholder transfers.

Shareholder-backed annuity business

The principal items affecting the IFRS results of the UK shareholder-backed annuity business are mortality experience and assumptions, and credit risk. The assets covering the liabilities are principally debt securities and other investments that are held to match the expected duration and payment characteristics of the policyholder liabilities. These liabilities are valued for IFRS reporting purposes by applying discount rates that reflect the market rates of return attaching to the covering assets.

Except to the extent of any asset/liability duration mismatch which is reviewed regularly, and exposure to credit risk, the sensitivity of the Group's results to market risk for movements in the carrying value of the liabilities and covering assets is broadly neutral on a net basis.

The main market risk sensitivity for the UK shareholder-backed annuity business arises from interest rate risk on the debt securities which substantially represent shareholders' equity. This shareholders' equity comprises the net assets

held within the long-term fund of the company that cover regulatory basis liabilities that are not recognised for IFRS reporting purposes, for example contingency reserves, and shareholder capital held outside the long-term fund.

In summary, profits from shareholder-backed annuity business are most sensitive to:

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

A decrease in assumed mortality rates of 1 per cent would decrease pre-tax profits by approximately £94 million (2013: £71 million). A decrease in credit default assumptions of five basis points would increase pre-tax profits by £190 million (2013: £151 million). A decrease in renewal expenses (excluding asset management expenses) of 5 per cent would increase pre-tax profits by £30 million (2013: £27 million). The effect on profits would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above. The net effect on profit after tax and shareholders' equity from all the changes in assumptions as described above would be an increase of approximately £101 million (2013: £86 million).

Unit-linked and other business

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

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

(i) Sensitivity to interest rate risk and other market risk

By virtue of the fund structure, product features and basis of accounting, the policyholder liabilities of the UK insurance operations are, except annuity business, not generally exposed to interest rate risk.

At 31 December 2014 annuity liabilities accounted for 98 per cent (2013: 98 per cent) of UK shareholder-backed business liabilities. For annuity business, liabilities are exposed to interest rate risk. However, the net exposure to the Prudential Assurance Company with-profits sub-fund (for its non-profit annuity business) and shareholders (for annuity liabilities of Prudential Retirement Income Limited and the non-profit sub-fund) is very substantially ameliorated by virtue of the close matching of assets with appropriate duration. The level of matching from period to period can vary depending on management actions and economic factors so it is possible for a degree of mis-matching profits or losses to arise.

The close matching by the Group of assets of appropriate duration to annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and IFRS is not the same with contingency reserves and some other margins for prudence within the assumptions required under the regulatory solvency basis not included for IFRS reporting purposes. As a result IFRS equity is higher than regulatory

capital and therefore more sensitive to interest rate and credit risk.

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

| | 2014 £m | | | | 2013 £m | | | |
|--------------------------------------------------------------|------------------|------------------|-------------------|-------------------|------------------|------------------|-------------------|-------------------|
| | A decrease of 2% | A decrease of 1% | An increase of 1% | An increase of 2% | A decrease of 2% | A decrease of 1% | An increase of 1% | An increase of 2% |
| Carrying value of debt securities and derivatives | 11,559 | 5,063 | (4,085) | (7,457) | 8,602 | 3,843 | (3,170) | (5,827) |
| Policyholder liabilities | (9,550) | (4,250) | 3,454 | 6,297 | (7,525) | (3,366) | 2,762 | 5,054 |
| Related deferred tax effects | (402) | (163) | 126 | 232 | (215) | (95) | 82 | 155 |
| Net sensitivity of profit after tax and shareholders' equity | 1,607 | 650 | (505) | (928) | 862 | 382 | (326) | (618) |

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

| | 2014 £m | | 2013 £m | |
|--------------------------------------------------------------|-------------------|-------------------|-------------------|-------------------|
| | A decrease of 20% | A decrease of 10% | A decrease of 20% | A decrease of 10% |
| Pre-tax profit | (347) | (173) | (309) | (154) |
| Related deferred tax effects | 75 | 37 | 72 | 36 |
| Net sensitivity of profit after tax and shareholders' equity | (272) | (136) | (237) | (118) |

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

C7.5 Asset management and other operations

(a) Asset management

(i) Sensitivities to foreign exchange risk

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

A 10 per cent increase in the relevant exchange rates would have reduced reported profit before tax attributable to shareholders and shareholders' equity, excluding goodwill attributable to Eastspring Investments and US asset management operations, by £9 million (2013: £12 million) and £33 million (2013: £29 million) respectively.

(ii) Sensitivities to other financial risks for asset management operations

The principal sensitivities to other financial risk of asset management operations are credit risk on the bridging loan portfolio of the Prudential Capital operation and the indirect effect of changes to market values of funds under

management. Due to the nature of the asset management operations there is limited direct sensitivity to movements in interest rates. Total debt securities held at 31 December 2014 by asset management operations were £2,293 million (2013: £2,045 million), the majority of which are held by the Prudential Capital's operation. Debt securities held by Prudential Capital are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholders' equity. The Group's asset management operations do not hold significant investments in property or equities.

(b) Other operations

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

C8 Tax assets and liabilities

C8.1 Deferred tax

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

| | Deferred tax assets | | Deferred tax liabilities | |
|---------------------------------------------------------|---------------------|---------|--------------------------|---------|
| | 2014 £m | 2013 £m | 2014 £m | 2013 £m |
| Unrealised losses or gains on investments | 83 | 315 | (1,697) | (1,450) |
| Balances relating to investment and insurance contracts | 4 | 8 | (499) | (451) |
| Short-term temporary differences | 2,607 | 2,050 | (2,065) | (1,861) |
| Capital allowances | 9 | 10 | (30) | (16) |
| Unused deferred tax losses | 62 | 29 | - | - |
| Total | 2,765 | 2,412 | (4,291) | (3,778) |

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

The table that follows provides a breakdown of the recognised deferred tax assets set out in the table above for both the short-term temporary differences and unused tax losses split by business unit. The table also shows the period of estimated recoverability for each respective business unit. For these and each category of deferred tax asset recognised their recoverability against forecast taxable profits is not significantly impacted by any current proposed changes to future accounting standards.

| | Short-term temporary differences | | Unused tax losses | |
|---------------------------|----------------------------------|-----------------------------------|-------------------|-----------------------------------|
| | 2014 £m | Expected period of recoverability | 2014 £m | Expected period of recoverability |
| Asia insurance operations | 30 | 1 to 3 years | 47 | 3 to 5 years |
| US insurance operations | 2,268 | With run-off of in-force book | - | - |
| UK insurance operations | 129 | 1 to 10 years | - | 1 to 3 years |
| Other operations | 180 | 1 to 10 years | 15 | 1 to 3 years |
| Total | 2,607 | | 62 | |

The taxation regimes applicable across the Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the

recognition of deferred tax assets. Accordingly, for the 2014 full year results and financial position at 31 December 2014 the possible tax benefit of approximately £110 million (2013: £127 million), which may arise from capital losses valued at approximately £0.5 billion (2013: £0.6 billion), is sufficiently uncertain that it has not been recognised. In addition, a potential deferred tax asset of £47 million (2013: £61 million), which may arise from trading tax losses and other potential temporary differences totalling £0.2 billion (2013: £0.4 billion) is sufficiently uncertain that it has not been recognised. Of these, losses of £32 million will expire within the next seven years. Of the remaining losses £1 million will expire within 20 years and the rest have no expiry date.

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

C8.2 Current tax asset and liability

Of the £117 million (2013: £244 million) current tax recoverable, the majority is expected to be recovered in one year or less.

The current tax liability increased to £617 million (2013: £395 million) reflecting the increase in shareholder profits.

C9 Defined benefit pension schemes

(a) Background and summary economic and IAS 19 financial positions

The Group's businesses operate a number of pension schemes. The specific features of these plans vary in accordance with the regulations of the country in which the employees are located, although they are, in general, funded by the Group and based either on a cash balance formula or on years of service and salary earned in the last year or years of employment. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). PSPS accounts for 84 per cent (2013: 84 per cent) of the underlying scheme liabilities of the Group's defined benefit schemes.

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

Under the IAS 19 'Employee Benefits' valuation basis, the Group applies the principles of IFRIC 14, 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', whereby a surplus is only recognised to the extent that the Company is able to access the surplus either through an unconditional right of refund to the surplus or through reduced future contributions relating to ongoing service, which have been substantively enacted or contractually agreed. Further, the IFRS financial position recorded, reflects the higher of any underlying IAS 19 deficit and any obligation for committed deficit funding where applicable.

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

| | 2014 £m | | | | | 2013 £m | | | | |
|------------------------------------------------------------------------------------|------------------|--------------------|--------|------------------|-------|------------------|--------------------|--------|------------------|-------|
| | PSPS note (i) | SASPS note (ii) | M&GGPS | Other schemes | Total | PSPS note (i) | SASPS note (ii) | M&GGPS | Other schemes | Total |
| Underlying economic surplus (deficit) | 840 | (144) | 60 | (1) | 755 | 726 | (115) | 36 | (1) | 646 |
| Less: unrecognised surplus note (i) | (710) | - | - | - | (710) | (602) | - | - | - | (602) |
| Economic surplus (deficit) (including investment in Prudential insurance policies) | 130 | (144) | 60 | (1) | 45 | 124 | (115) | 36 | (1) | 44 |

Attributable to:

| | | | | | | | | | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|-------|-------|-----|-------|-----|-------|-------|-----|-------|
| PAC with-profits fund | 91 | (72) | - | - | 19 | 87 | (58) | - | - | 29 |
| Shareholder-backed operations | 39 | (72) | 60 | (1) | 26 | 37 | (57) | 36 | (1) | 15 |
| Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policiesnote (iii) IAS 19 pension asset (liability) on the Group statement of financial positionnote (iv) | - | - | (132) | - | (132) | - | - | (114) | - | (114) |
| | 130 | (144) | (72) | (1) | (87) | 124 | (115) | (78) | (1) | (70) |

Notes

- (i) For PSPS, the Group does not have an unconditional right of refund to any surplus of the scheme. The PSPS pension asset represents the present value of the economic benefit (impact) of the Company from the difference between future ongoing contributions to the scheme and estimated accrued cost of service. No deficit or other funding is required for PSPS. Deficit funding, where applicable, is apportioned in the ratio of 70/30 between the PAC with-profits fund and shareholder-backed operations following detailed considerations in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity.
- (ii) The deficit of SASPS has been allocated approximately 50 per cent to the PAC with-profits fund and 50 per cent to the shareholders' fund.
- (iii) The underlying position on an economic basis reflects the assets (including investments in Prudential insurance policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes.
- (iv) At 31 December 2014, the PSPS pension asset of £130 million (2013: £124 million) and the other schemes' pension liabilities of £217 million (2013: £194 million) are included within 'Other debtors' and 'Provisions' respectively on the consolidated statement of financial position.

Triennial actuarial valuations

All of the schemes are required to carry out a full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds.

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

| | PSPS | SASPS | M&GGPS |
|----------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|-------------------------------------------|---------------------------------------------------|
| Last completed actuarial valuation date | 5 April 2011 | 31 March 2011 | 31 December 2011 |
| Valuation actuary, all Fellow of the Institute and Faculty of Actuaries | C.G. Singer Towers Watson Limited | Jonathan Seed Xafinity Consulting | Paul Belok AON Hewitt Limited |
| Funding level at the last valuation | 111 per cent* No deficit or other funding required. Future ongoing contributions for active members were | 85 per cent | 83 per cent |
| Deficit funding arrangement agreed with the Trustees based on the last valuation | | £13.1 million per annum January 2013; and | £18.6 million per annum for two years beginning 1 |

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reduced to the minimum level required under the scheme rules from July 2012 (approximately £6 million per annum excluding expenses) until 31 December 2018. The deficit will be reviewed every three years at subsequent valuations £9.3 million for the year beginning 1 January 2015

The next triennial valuations for the PSPS, SASPS and M&GGPS as at 5 April 2014, 31 March 2014 and 31 December 2014, respectively are currently in progress.

(b) Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the years ended 31 December were as follows:

| | 2014 % | 2013 % |
|--------------------------------------------------------|--------|--------|
| Discount rate* | 3.5 | 4.4 |
| Rate of increase in salaries | 3.0 | 3.3 |
| Rate of inflation** | | |
| Retail prices index (RPI) | 3.0 | 3.3 |
| Consumer prices index (CPI) | 2.0 | 2.3 |
| Rate of increase of pensions in payment for inflation: | | |
| PSPS: | | |
| Guaranteed (maximum 5%) | 2.5 | 2.5 |
| Guaranteed (maximum 2.5%) | 2.5 | 2.5 |
| Discretionary | 2.5 | 2.5 |
| Other schemes | 3.0 | 3.3 |

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

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

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The specific allowance made is in line with a custom calibration and has been updated in 2014 to reflect the 2012 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries (CMI). The tables used for PSPS immediate annuities in payment at 31 December 2014 were:

Male: 114.0 per cent PNMA00 with improvements in line with a custom calibration of the CMI's 2012 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and

Female: 108.5 per cent PNFA00 with improvements in line with a custom calibration of the CMI's 2012 mortality model, with a long-term mortality improvement rate of 1.25 per cent per annum.

The tables used for PSPS immediate annuities in payment at 31 December 2013 were:

Male: 112.0 per cent PNMA00 with improvements in line with a custom calibration of the CMI's 2011 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and
 Female: 108.5 per cent PNFA00 with improvements in line with a custom calibration of the CMI's 2011 mortality model, with a long-term mortality improvement rate of 1.25 per cent per annum.

Using external actuarial advice provided by the scheme actuaries being Towers Watson for the valuation of PSPS, Xafinity Consulting for SASPS and Aon Hewitt Limited for the M&GGPS, the most recent full valuations have been updated to 31 December 2014, applying the principles prescribed by IAS 19.

(c) Estimated pension scheme surpluses and deficits

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. The IAS 19 basis excludes the investments in Prudential policies. At 31 December 2014, the investments in Prudential insurance policies comprise £131 million (2013: £143 million) for PSPS and £132 million (2013: £114 million) for the M&GGPS. In principle, on consolidation the investments are eliminated against policyholder liabilities of UK insurance operations, so that the formal IAS 19 position for the scheme in isolation excludes these items. This treatment applies to the M&GGPS investments. However, as a substantial portion of the Company's interest in the underlying surplus of PSPS is not recognised, the adjustment is not necessary for the PSPS investments.

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

| | 2014 £m | | | | |
|---------------------------------------------------------------|-------------------------------------------------------------------|-------------------------------------------------------------|--------------------------------------|--------------------|---------------------------------------------|
| | (Charge) credit to income statement or other comprehensive income | | | | |
| | Surplus (deficit) in schemes at 1 Jan 2014 | Operating results (based on longer-term investment returns) | Actuarial and other gains and losses | Contributions paid | Surplus (deficit) in schemes at 31 Dec 2014 |
| All schemes | | | | | |
| Underlying position (without the effect of IFRIC 14) | | | | | |
| Surplus | 646 | (8) | 62 | 55 | 755 |
| Less: amount attributable to PAC with-profits fund | (457) | (4) | (49) | (15) | (525) |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | 189 | (12) | 13 | 40 | 230 |
| Related tax | (38) | 2 | (2) | (8) | (46) |
| Net of shareholders' tax | 151 | (10) | 11 | 32 | 184 |
| Application of IFRIC 14 for the derecognition of PSPS surplus | | | | | |
| Derecognition of surplus | (602) | (26) | (82) | - | (710) |
| Less: amount attributable to PAC with-profits fund | 428 | 18 | 60 | - | 506 |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | (174) | (8) | (22) | - | (204) |
| Related tax | 35 | 2 | 4 | - | 41 |
| Net of shareholders' tax | (139) | (6) | (18) | - | (163) |
| With the effect of IFRIC 14 | | | | | |
| Surplus (deficit) | 44 | (34) | (20) | 55 | 45 |

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| | | | | | |
|----------------------------------------------------|------|------|-----|------|------|
| Less: amount attributable to PAC with-profits fund | (29) | 14 | 11 | (15) | (19) |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | 15 | (20) | (9) | 40 | 26 |
| Related tax | (3) | 4 | 2 | (8) | (5) |
| Net of shareholders' tax | 12 | (16) | (7) | 32 | 21 |

Underlying investments of the schemes

On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the plans' assets at 31 December comprise the following investments:

| | 2014 | | | | 2013 | | | |
|-------------------------|--------------|-------|-------|-----|--------------|-----|-------|-----|
| | Other | | Total | % | Other | | Total | % |
| | PSPS schemes | £m | | | PSPS schemes | £m | | |
| Equities | £m | £m | £m | % | £m | £m | £m | % |
| UK | 126 | 86 | 212 | 2 | 133 | 76 | 209 | 3 |
| Overseas | 143 | 317 | 460 | 6 | 12 | 317 | 329 | 5 |
| Bonds*: | | | | | | | | |
| Government | 5,078 | 440 | 5,518 | 68 | 4,288 | 311 | 4,599 | 66 |
| Corporate | 931 | 117 | 1,048 | 13 | 715 | 107 | 822 | 12 |
| Asset-backed securities | 197 | 26 | 223 | 3 | 45 | 17 | 62 | 1 |
| Derivatives | 159 | (13) | 146 | 2 | 91 | 6 | 97 | 1 |
| Properties | 93 | 57 | 150 | 2 | 71 | 44 | 115 | 2 |
| Other assets | 270 | 40 | 310 | 4 | 687 | 24 | 711 | 10 |
| Total value of assets | 6,997 | 1,070 | 8,067 | 100 | 6,042 | 902 | 6,944 | 100 |

* 94 per cent of the bonds are investment graded (2013: 97 per cent).

(d) Sensitivity of the pension scheme liabilities to key variables

The total underlying Group pension scheme liabilities of £7,312 million (2013: £6,298 million) comprise £6,157 million (2013: £5,316 million) for PSPS and £1,155 million (2013: £982 million) for the other schemes. The table below shows the sensitivity of the underlying PSPS and the other scheme liabilities at 31 December 2014 and 2013 to changes in discount rate, inflation rates and mortality rates. The sensitivity information below is based on the core scheme liabilities and assumptions at the balance sheet date. The sensitivity is calculated based on a change in one assumption with all other assumptions being held constant. As such, interdependencies between the assumptions are excluded.

The sensitivity of the underlying pension scheme liabilities as shown above does not directly equate to the impact on the profit or loss attributable to shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund as described above.

| | Assumption applied | | Sensitivity change in assumption | Impact of sensitivity on scheme liabilities on IAS 19 basis | 2014 | | 2013 | |
|---------------|--------------------|------|----------------------------------|-------------------------------------------------------------|------|------|------|--|
| | 2014 | 2013 | | | 2014 | 2013 | | |
| Discount rate | 3.5% | 4.4% | Decrease by 0.2% | Increase in scheme liabilities by: | | | | |
| | | | | PSPS | 3.4% | 3.3% | | |

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| | | | | | | |
|-------------------|------|-----------|-----------------------------------------------|------------------------------------|------|------|
| | | | | Other schemes | 5.2% | 5.1% |
| Discount rate | 3.5% | 4.4% | Increase by 0.2% | Decrease in scheme liabilities by: | | |
| | | | | PSPS | 3.2% | 3.1% |
| | | | | Other schemes | 4.9% | 4.7% |
| Rate of inflation | 3.0% | RPI: 3.3% | RPI: Decrease by 0.2% | Decrease in scheme liabilities by: | | |
| | 2.0% | CPI: 2.3% | CPI: Decrease by 0.2% | PSPS | 0.6% | 0.7% |
| | | | with consequent reduction in salary increases | Other schemes | 4.2% | 4.6% |
| Mortality rate | | | Increase life expectancy by 1 year | Increase in scheme liabilities by: | | |
| | | | | PSPS | 3.3% | 2.7% |
| | | | | Other schemes | 3.0% | 2.7% |

C10 Share capital, share premium and own shares

| | 2014 | | | 2013 | | |
|-----------------------------------------|---------------------------|---------------------|---------------------|---------------------------|---------------------|---------------------|
| | Number of ordinary shares | Share capital £m | Share premium £m | Number of ordinary shares | Share capital £m | Share premium £m |
| Issued shares of 5p each fully paid: | | | | | | |
| At 1 January | 2,560,381,736 | 128 | 1,895 | 2,557,242,352 | 128 | 1,889 |
| Shares issued under share-based schemes | 7,398,214 | - | 13 | 3,139,384 | - | 6 |
| At 31 December | 2,567,779,950 | 128 | 1,908 | 2,560,381,736 | 128 | 1,895 |

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

At 31 December 2014, there were options outstanding under Save As You Earn schemes to subscribe for shares as follows:

| | Number of shares to subscribe for | Share price range | Exercisable by year |
|------------------|-----------------------------------|---------------------|---------------------|
| 31 December 2014 | 8,624,491 | from 288p to 1,155p | 2020 |
| 31 December 2013 | 10,233,986 | 288p to 901p | 2019 |

Transactions by Prudential plc and its subsidiaries in Prudential plc shares

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The Group buys and sells Prudential plc ('own shares') either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £195 million as at 31 December 2014 (2013: £141 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 31 December 2014, 10.3 million (2013: 7.1 million) Prudential plc shares with a market value of £153.1 million (2013: £94.5 million) were held in such trusts all of which are for employee incentive plans. The maximum number of shares held during 2014 was 10.3 million which was in December 2014.

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

| | Number of shares | 2014 Share Price | | | Number of shares | 2013 Share Price | | |
|-----------|---------------------|------------------|-----------|-------------|---------------------|------------------|-----------|------------|
| | | Low £ | High £ | Cost £ | | Low £ | High £ | Cost £ |
| January | 13,740 | 13.56 | 13.56 | 186,314 | 11,864 | 9.15 | 9.15 | 108,496 |
| February | 16,841 | 12.77 | 12.77 | 215,060 | 10,900 | 9.25 | 9.25 | 100,868 |
| March | 4,623,303 | 12.82 | 13.59 | 60,161,823 | 11,342 | 10.15 | 10.15 | 115,121 |
| April | 149,199 | 13.12 | 13.48 | 2,006,955 | 894,567 | 10.30 | 10.86 | 9,692,613 |
| May | 1,361,688 | 13.90 | 14.13 | 19,184,679 | 54,781 | 11.56 | 11.72 | 643,608 |
| June | 11,290 | 13.80 | 13.80 | 155,802 | 15,950 | 10.89 | 11.11 | 176,139 |
| July | 10,745 | 13.83 | 13.83 | 148,550 | 11,385 | 11.20 | 11.20 | 135,132 |
| August | 11,321 | 13.22 | 13.22 | 149,607 | 924,499 | 11.48 | 11.94 | 10,955,609 |
| September | 355,268 | 14.18 | 14.41 | 5,074,731 | 10,960 | 11.38 | 11.38 | 124,725 |
| October | 51,199 | 13.75 | 13.84 | 704,601 | 103,999 | 11.54 | 11.69 | 1,201,870 |
| November | 51,314 | 14.36 | 14.47 | 737,173 | 12,108 | 12.52 | 12.65 | 151,773 |
| December | 1,223,290 | 14.41 | 15.47 | 17,983,248 | 2,362,435 | 12.63 | 12.93 | 30,377,986 |
| Total | 7,879,198 | | | 106,708,543 | 4,424,790 | | | 53,783,940 |

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 31 December 2014 was 7.5 million (2013: 7.1 million) and the cost of acquiring these shares of £67 million (2013: £60 million) is included in the cost of own shares. The market value of these shares as at 31 December 2014 was £112 million (2013: £95 million). During 2014, these funds made net additions of 405,940 Prudential shares (2013: net additions of 2,629,816) for a net increase of £7 million to book cost (2013: net increase of £33 million).

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

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during 2014 or 2013.

D OTHER NOTES

D1 Corporate transactions

(a) Sale of PruHealth and PruProtect business

On 10 November 2014, the Prudential Assurance Company Limited announced an agreement to sell its 25 per cent equity stake in the PruHealth and PruProtect business to Discovery Group Europe Limited ("Discovery") for £155 million in cash.

The sale was completed on 14 November 2014. This transaction gave rise to a gain on disposal of £86 million. This amount is shown separately in the Group's supplementary analysis of profit excluded from the Group's IFRS operating profit based on longer-term investment returns. The net cash inflow arising from this sale, as shown in the consolidated statement of cash flows, of £152 million, comprised the net cash proceeds received.

(b) Held for sale Japan Life business

On 5 February 2015, the Group announced that it had completed the sale of its closed book life insurance business in Japan, PCA Life Insurance Company Limited to SBI Holdings, Inc. following regulatory approvals. The transaction was announced on 16 July 2013. Of the agreed US\$85 million cash consideration, the Group received US\$68 million on completion of the transaction, and a further payment of up to US\$17 million will be received contingent upon the future performance of the Japan Life business.

The Japan Life business has been classified as held for sale in these consolidated financial statements in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations'.

The assets and liabilities of the Japan Life business classified as held for sale on the statement of financial position as at 31 December 2014 are as follows:

| | 2014 £m | 2013 £m |
|-------------------------------------------------------------------------------------|---------|---------|
| Assets | | |
| Investments | 898 | 956 |
| Other assets | 45 | 80 |
| | 943 | 1,036 |
| Adjustment for remeasurement of the carrying value to fair value less costs to sell | (124) | (120) |
| Assets held for sale | 819 | 916 |
| Liabilities | | |
| Policyholder liabilities | 717 | 814 |
| Other liabilities | 53 | 54 |
| Liabilities held for sale | 770 | 868 |
| Net assets | 49 | 48 |

The remeasurement of the carrying value of the Japan Life business on classification as held for sale resulted in a charge of £(13) million (2013: £(120) million) as shown in the income statement. These amounts, together with the results of the business including short-term value movements on investments are included within "Loss attaching to held for sale Japan Life business" in the supplementary analysis of profit of the Group as shown in note B1.1

(c) Bancassurance partnership with Standard Chartered Bank

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 Bank. Under the new 15-year agreement, which commenced on 1 July 2014, a wide range of Prudential life insurance products are exclusively distributed through Standard Chartered Bank 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 distributes 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 for distribution rights 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.

(d) Acquisition of Thanachart Life Assurance Company Limited and bancassurance partnership agreement with Thanachart Bank

On 3 May 2013, the agreement Prudential plc, through its subsidiary Prudential Life Assurance (Thailand) Public Company Limited (Prudential Thailand), entered into in November 2012 to establish an exclusive 15-year partnership with Thanachart Bank Public Company Limited (Thanachart Bank) to develop jointly their bancassurance business in Thailand was launched. At the same time, Prudential Thailand completed the acquisition of 100 per cent of the voting interest in Thanachart Life Assurance Company Limited (Thanachart Life), a wholly-owned life insurance subsidiary of Thanachart Bank.

The consideration for the transaction was THB 18.981 billion (£412 million), of which THB 17.500 billion (£380 million) was settled in cash on completion in May 2013 with a further payment of THB 0.946 billion (£20 million), for adjustments to reflect the net asset value as at completion date, paid in July 2013. In addition a deferred payment of THB 0.535 billion (£12 million) was paid 12 months after completion. Included in the total consideration of THB 18.981 billion (£412 million) was the cost of the distribution rights associated with the exclusive 15-year bancassurance partnership agreement with Thanachart Bank.

D2 Domestication of the Hong Kong branch business

On 1 January 2014, following consultation with policyholders of PAC and regulators and court approval, the Hong Kong branch of PAC was transferred to separate subsidiaries established in Hong Kong. On an IFRS basis, approximately £12.6 billion of assets, £12.3 billion of liabilities (including policyholder liabilities of £10.2 billion and £1.7 billion of unallocated surplus) and £0.3 billion of shareholders' funds (for the excess assets of the transferred non-participating business) were transferred.

The costs of enabling the domestication in 2014 were £5 million (2013: £35 million). Within the Group's supplementary analysis of profit, these costs have been presented as a separate category of items excluded from operating profit based on longer-term investment returns as shown in note B1.1.

D3 Contingencies and related obligations

The Group is involved in a number of litigation and regulatory issues. These include civil proceedings involving Jackson, which appear to be substantially similar to other class action litigation brought against many life insurers in the US, alleging misconduct in the sale of insurance products. Whilst 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.

D4 Post balance sheet events

Completion of the sale of Japan Life business

On the 5 February 2015, the Group announced that it had completed the sale of its closed book life insurance business in Japan, as described further in note D1(b).

Final dividend

The 2014 final dividend approved by the Board of Directors after 31 December 2014 is as described in note B7.

Additional Unaudited IFRS Financial Information

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

This schedule classifies the Group's pre-tax operating earnings from long-term insurance operations into the underlying drivers of those profits, using the following categories:

- Spread income represents the difference between net investment income (or premium income in the case of the UK annuities new business) and amounts credited to certain policyholder accounts. It excludes the operating investment return on shareholder net assets, which has been separately disclosed as expected return on shareholder assets.
- Fee income represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.
- With-profits business represents the gross of tax shareholders' transfer from the with-profits fund for the year.
- Insurance margin primarily represents profits derived from the insurance risks of mortality and morbidity.
- Margin on revenues primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.
- Acquisition costs and administration expenses represent expenses incurred in the year attributable to shareholders. It excludes items such as restructuring costs and Solvency II costs which are not included in the segment profit for insurance as well as items that are more appropriately included in other source of earnings lines (eg investment expenses are netted against investment income as part of spread income or fee income as appropriate).
- DAC adjustments comprises DAC amortisation for the year, excluding amounts related to short-term fluctuations in investment returns, net of costs deferred in respect of new business.

Analysis of pre-tax IFRS operating profit by source and Margin analysis of Group long-term insurance business

The following analysis expresses certain of the Group's sources of operating profit as a margin of policyholder liabilities or other suitable driver. Details on the calculation of the Group's average policyholder liability balances are given in note (iii).

| | 2014 £m | | | | Average Liability note (iv) | Total bps note(ii) |
|---------------------------------------|------------------|-------|-------|---------|--------------------------------|--------------------------|
| | Asia note (v) | US | UK | Total | | |
| Spread income | 125 | 734 | 272 | 1,131 | 67,252 | 168 |
| Fee income | 155 | 1,402 | 61 | 1,618 | 110,955 | 146 |
| With-profits | 43 | - | 255 | 298 | 101,290 | 29 |
| Insurance margin | 675 | 670 | 96 | 1,441 | | |
| Margin on revenues | 1,545 | - | 176 | 1,721 | | |
| Expenses: | | | | | | |
| Acquisition costsnote (i) | (1,031) | (887) | (96) | (2,014) | 4,650 | (43)% |
| Administration expenses | (618) | (693) | (143) | (1,454) | 186,049 | (78) |
| DAC adjustmentsnote (vi) | 92 | 191 | (6) | 277 | | |
| Expected return on shareholder assets | 64 | 14 | 137 | 215 | | |
| Long-term business operating profit | 1,050 | 1,431 | 752 | 3,233 | | |

See notes at the end of this section.

| | 2013 AER £m | | | | Average | Total |
|--|-------------|----|----|-------|---------|-------|
| | Asia | US | UK | Total | | |

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| | note (v) | | | | Liability note (iv) | bps note(ii) |
|---------------------------------------|----------|-------|-------|---------|------------------------|-----------------|
| Spread income | 115 | 730 | 228 | 1,073 | 64,312 | 167 |
| Fee income | 154 | 1,172 | 65 | 1,391 | 96,337 | 144 |
| With-profits | 47 | - | 251 | 298 | 97,393 | 31 |
| Insurance margin | 679 | 588 | 89 | 1,356 | | |
| Margin on revenues | 1,562 | | 187 | 1,749 | | |
| Expenses: | | | | | | |
| Acquisition costsnote (i) | (1,015) | (914) | (110) | (2,039) | 4,423 | (46)% |
| Administration expenses | (634) | (670) | (124) | (1,428) | 169,158 | (84) |
| DAC adjustmentsnote (vi) | 35 | 313 | (14) | 334 | | |
| Expected return on shareholder assets | 58 | 24 | 134 | 216 | | |
| Long-term business operating profit | 1,001 | 1,243 | 706 | 2,950 | | |

See notes at the end of this section.

| | 2013 CER £m note (iii) | | | | Average Liability note (iv) | Total bps note (ii) |
|---------------------------------------|---------------------------|-------|-------|---------|-----------------------------------|---------------------------|
| | Asia note (v) | US | UK | Total | | |
| Spread income | 107 | 694 | 228 | 1,029 | 62,909 | 164 |
| Fee income | 140 | 1,113 | 65 | 1,318 | 93,339 | 141 |
| With-profits | 44 | - | 251 | 295 | 97,374 | 30 |
| Insurance margin | 616 | 559 | 89 | 1,264 | | |
| Margin on revenues | 1,413 | - | 187 | 1,600 | | |
| Expenses: | | | | | | |
| Acquisition costsnote (i) | (921) | (868) | (110) | (1,899) | 4,165 | (46)% |
| Administration expenses | (578) | (636) | (124) | (1,338) | 164,362 | (81) |
| DAC adjustmentsnote (vi) | 32 | 297 | (14) | 315 | | |
| Expected return on shareholder assets | 52 | 22 | 134 | 208 | | |
| Long-term business operating profit | 905 | 1,181 | 706 | 2,792 | | |

See notes at the end of this section.

Margin analysis of long-term insurance business - Asia

| | 2014 | | | Asia notes (iii), (v) 2013 AER | | | 2013 CER | | |
|--------------------|--------------|-----------------|----------------------------|-----------------------------------------|-----------------|----------------------------|--------------|-----------------|-----------------------------------------|
| | Average | | | Average | | | Average | | |
| Long-term business | Profit £m | Liability £m | Margin note (ii) bps | Profit £m | Liability £m | Margin note (iv) bps | Profit £m | Liability £m | Margin note (iv) note (ii) bps |
| Spread income | 125 | 9,183 | 136 | 115 | 7,446 | 154 | 107 | 7,419 | 144 |
| Fee income | 155 | 14,987 | 103 | 154 | 13,714 | 112 | 140 | 13,317 | 105 |
| With-profits | 43 | 14,823 | 29 | 47 | 13,263 | 35 | 44 | 13,244 | 33 |
| Insurance margin | 675 | | | 679 | | | 616 | | |

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| | | | | | | | | | |
|---------------------------------------|---------|--------|-------|---------|--------|-------|-------|--------|-------|
| Margin on revenues | 1,545 | | | 1,562 | | | 1,413 | | |
| Expenses: | | | | | | | | | |
| Acquisition costsnote (i) | (1,031) | 2,237 | (46)% | (1,015) | 2,125 | (48)% | (921) | 1,946 | (47)% |
| Administration expenses | (618) | 24,170 | (256) | (634) | 21,160 | (300) | (578) | 20,736 | (279) |
| DAC adjustmentsnote (vi) | 92 | | | 35 | | | 32 | | |
| Expected return on shareholder assets | 64 | | | 58 | | | 52 | | |
| Operating profit | 1,050 | | | 1,001 | | | 905 | | |
| See notes at the end of the section. | | | | | | | | | |

Analysis of Asia operating profit drivers

- Spread income has increased by 17 percent at constant exchange rate (AER 9 per cent) to £125 million in 2014, predominantly reflecting the growth of the Asia non-linked policyholder liabilities.
- Fee income has increased by 11 per cent at constant exchange rates (AER 1 per cent) from £140 million in full year 2013 to £155 million in 2014, broadly in line with the increase in movement in average unit-linked liabilities.
- Insurance margin has increased by £59 million at constant exchange rates to £675 million in 2014 predominantly reflecting the continued growth of the in-force book, which contains a relatively high proportion of risk-based products. 2014 insurance margin includes non-recurring items of £27 million (full year 2013: £52 million at AER; £48 million on CER).
- Excluding the adverse impact of currency fluctuations, margin on revenues has increased by £132 million from £1,413 million in 2013 to £1,545 million in 2014 primarily reflecting higher premium income recognised in the period.
- Acquisition costs have increased by 12 per cent at constant exchange rates (AER 2 per cent) to £1,031 million in 2014, compared to the 15 per cent increase in sales (AER 5 per cent increase), resulting in a modest decrease in the acquisition costs ratio. The analysis above uses shareholder acquisition costs as a proportion of total APE. If with-profits sales were excluded from the denominator the acquisition cost ratio would become 66 per cent (full year 2013: 65 per cent at CER), broadly consistent with the prior year.
- Administration expenses have increased by 7 per cent at constant exchange rates (AER 3 per cent decrease) to £618 million in 2014 as the business continues to expand. On constant exchange rates, the administration expense ratio has reduced from 279 basis points in 2013 to 256 basis points in 2014.
- Expected return on shareholder assets have increased from £52 million in 2013 to £64 million in 2014 primarily due to higher income from increased shareholder assets.

Margin analysis of long-term insurance business - US

| 2014 | | | US note (iii) 2013 AER | | | 2013 CER | | |
|-----------|------------------|--------|------------------------------|------------------|--------|-----------|------------------|--------|
| Average | Profit Liability | Margin | Average | Profit Liability | Margin | Average | Profit Liability | Margin |
| note (iv) | note (ii) | | note (iv) | note (ii) | | note (iv) | note (ii) | |

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| Long-term business | £m | £m | bps | £m | £m | bps | £m | £m | bps |
|---------------------------------------|-------|---------|-------|-------|--------|-------|-------|--------|-------|
| Spread income | 734 | 28,650 | 256 | 730 | 29,648 | 246 | 694 | 28,272 | 246 |
| Fee income | 1,402 | 72,492 | 193 | 1,172 | 59,699 | 196 | 1,113 | 57,098 | 195 |
| Insurance margin | 670 | | | 588 | | | 559 | | |
| Expenses | | | | | | | | | |
| Acquisition costsnote (i) | (887) | 1,556 | (57)% | (914) | 1,573 | (58)% | (868) | 1,494 | (58)% |
| Administration expenses | (693) | 108,984 | (64) | (670) | 97,856 | (68) | (636) | 93,484 | (68) |
| DAC adjustments | 191 | | | 313 | | | 297 | | |
| Expected return on shareholder assets | 14 | | | 24 | | | 22 | | |
| Operating profit | 1,431 | | | 1,243 | | | 1,181 | | |
| See notes at the end of this section | | | | | | | | | |

Analysis of US operating profit drivers:

- Spread income has increased by 6 per cent at constant exchange rates (AER increased by 1 per cent) to £734 million during 2014. The reported spread margin increased to 256 basis points from 246 basis points in 2013. Spread income benefited from swap transactions previously entered into to more closely match the asset and liability duration. Excluding this effect, the spread margin would have been 182 basis points (2013 CER: 183 basis points)
- Fee income has increased by 26 per cent at constant exchange rates (AER 20 per cent) to £1,402 million during 2014, primarily due to higher average separate account balances resulting from positive net cash flows from variable annuity business and overall market appreciation. Fee income margin has remained broadly consistent with the prior year at 193 basis points (2013 CER: 195 basis points and AER:196 basis points), with the decrease primarily attributable to a change in the mix of business.
- Insurance margin represents operating profits from insurance risks, including variable annuity guarantees and other sundry items. Positive net flows from variable annuity business with life contingent and other guarantee fees, coupled with a benefit from re-pricing actions and an increased contribution from REALIC, have increased the insurance margin by 20 per cent at constant exchange rates (AER 14 per cent) to £670 million during 2014.
- Acquisition costs, which are commissions and expenses incurred to acquire new business, including those that are not deferrable, have decreased slightly in absolute terms and as a percentage of APE compared to 2013. As a percentage of APE, acquisition costs have remained relatively flat in comparison to 2013.
- Administration expenses increased to £693 million during 2014 compared to £636 million for 2013 at a constant exchange rate (AER £670 million), primarily as a result of higher asset based commissions paid on the larger 2014 separate account balance subject to these trail commissions. These are paid upon policy anniversary dates and are treated as an administration expense in this analysis. Excluding these trail commissions, the resulting administration expense ratio would be lower at 36 basis points (2013: CER 44 basis points and AER 44 basis points), reflecting the benefits of operational leverage.
- DAC adjustments decreased to £191 million during 2014 compared to £297 million at a constant exchange rate (AER £313 million) during 2013, with 2013 benefitting from a £78m (AER £82 million) deceleration in DAC amortisation due to strong equity market returns in that year. This was not repeated in 2014, which experienced an accelerated DAC amortisation charge of £13 million.

Analysis of pre-tax operating profit before and after acquisition costs and DAC adjustments

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| | 2014 £m | | | | 2013 AER £m | | | | 2013 CER £m note (iii) | | | |
|--------------------------------------------------------------------------------|-------------------------------|----------|----------|-------|-------------------------------|----------|----------|-------|-------------------------------|----------|----------|-------|
| | Acquisition costs | | | | Acquisition costs | | | | Acquisition costs | | | |
| | Other operating profits | Incurred | Deferred | Total | Other operating profits | Incurred | Deferred | Total | Other operating profits | Incurred | Deferred | Total |
| Total operating profit before acquisition costs and DAC adjustments | 2,127 | | | 2,127 | 1,844 | | | 1,844 | 1,752 | | | 1,752 |
| Less new business strain | | (887) | 678 | (209) | | (914) | 716 | (198) | | (868) | 680 | (188) |
| Other DAC adjustments - amortisation of previously deferred acquisition costs: | | | | | | | | | | | | |
| Normal (Accelerated) / Decelerated | | | (474) | (474) | | | (485) | (485) | | | (461) | (461) |
| Total | 2,127 | (887) | 191 | 1,431 | 1,844 | (914) | 313 | 1,243 | 1,752 | (868) | 297 | 1,181 |

Margin analysis of long-term insurance business - UK

| | UK | | | | | |
|-----------------------------------------|--------|-------------------|------------------|--------|-------------------|--------|
| | 2014 | | | 2013 | | |
| | Profit | Average Liability | Margin | Profit | Average Liability | Margin |
| Long-term business | £m | note (iv) £m | note (ii) bps | £m | note (iv) £m | bps |
| Spread income | 272 | 29,419 | 92 | 228 | 27,218 | 84 |
| Fee income | 61 | 23,476 | 26 | 65 | 22,924 | 28 |
| With-profits | 255 | 86,467 | 29 | 251 | 84,130 | 30 |
| Insurance margin | 96 | | | 89 | | |
| Margin on revenues | 176 | | | 187 | | |
| Expenses: | | | | | | |
| Acquisition costs note (i) | (96) | 857 | (11)% | (110) | 725 | (15)% |
| Administration expenses | (143) | 52,895 | (27) | (124) | 50,142 | (25) |
| DAC adjustments | (6) | | | (14) | | |
| Expected return on shareholders' assets | 137 | | | 134 | | |

| | | |
|------------------|-----|-----|
| Operating profit | 752 | 706 |
|------------------|-----|-----|

Analysis of UK operating profit drivers:

- Spread income has increased from £228 million in 2013 to £272 million in 2014 following an increase in bulk annuity sales which contributed £105 million (2013: £25 million) in the year partially offset by lower individual annuity sales.
- Fee income has reduced from £65 million in 2013 to £61 million in 2014 due to a change in product mix towards those with lower asset management charges, partly offset by an increase in funds under management.
- Insurance margin has increased from £89 million for full year 2013 to £96 million for full year 2014 primarily due to improved profits from protection business.
- Margin on revenues represents premiums charges for expenses and other sundry net income received by the UK. 2014 income was £176 million, £11 million lower than in 2013.
- Acquisition costs as a percentage of new business sales for full year 2014 decreased to 11 per cent from full year 2013 at 15 per cent, principally driven by the effect on this percentage ratio of business mix. The ratio above expresses the percentage of shareholder acquisition costs as a percentage of total APE sales. It is therefore impacted by the level of with-profit sales in the year. Acquisition costs as a percentage of shareholder-backed new business sales, excluding the bulk annuity transactions, were 36 per cent in 2014 (2013: 35 per cent).
- Administration expenses have increased from £124 million in 2013 to £143 million in 2014 largely due to increased investment spend to realign our business following the pension reforms announced in the UK Budget.

Notes

- (i) The ratio for acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business.
- (ii) Margin represents the operating return earned in the year as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus.
- (iii) The 2013 comparative information has been presented at Actual Exchange Rate (AER) and Constant Exchange Rates (CER) so as to eliminate the impact of exchange translation. CER results are calculated by translating prior year results using the current year foreign exchange rates. All CER profit figures have been translated at current year average rates. For Asia CER average liability calculations the policyholder liabilities have been translated using current year opening and closing exchange rates. For the US CER average liability calculations the policyholder liabilities have been translated at the current year month end closing exchange rates. See also Note A1.
- (iv) For UK and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the year, as a proxy for average balances throughout the year. The calculation of average liabilities for Jackson is derived from month end balances throughout the year as opposed to opening and closing balances only. Average liabilities for spread income are based on the general account liabilities to which spread income attaches. Average liabilities used to calculate the administrative expense margin exclude the REALIC liabilities reinsured to third parties prior to the acquisition by Jackson. Average liabilities are adjusted for business acquisitions and disposals in the period.
- (v) The 2014 and 2013 analyses exclude the results of the held for sale life insurance business of Japan in both the individual profit and average liability amounts shown in the table above.
- (vi) The DAC adjustment contains £11 million in respect of joint ventures in 2014 (2013: AER £1 million).

I(b) Asia operations - analysis of IFRS operating profit by territory

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

| | 2014 £m | AER 2013 £m | CER 2013 £m | 2014 AER vs 2013 | 2014 CER vs 2013 |
|-----------|---------|----------------|----------------|---------------------|---------------------|
| Hong Kong | 109 | 101 | 96 | 8% | 14% |
| Indonesia | 309 | 291 | 244 | 6% | 27% |

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| | | | | | |
|-------------------------------------------|-------|-------|-----|--------|--------|
| Malaysia | 118 | 137 | 125 | (14)% | (6)% |
| Philippines | 28 | 18 | 16 | 56% | 75% |
| Singapore | 214 | 219 | 205 | (2)% | 4% |
| Thailand | 53 | 53 | 48 | 0% | 10% |
| Vietnam | 72 | 54 | 51 | 33% | 41% |
| SE Asia Operations inc. Hong Kong | 903 | 873 | 785 | 3% | 15% |
| China | 13 | 10 | 10 | 30% | 30% |
| India | 49 | 51 | 47 | (4)% | 4% |
| Korea | 32 | 17 | 17 | 88% | 88% |
| Taiwan | 15 | 12 | 11 | 25% | 36% |
| Other | (9) | (4) | (4) | (125)% | (125)% |
| Non-recurrent itemsnote (ii) | 49 | 44 | 41 | 11% | 20% |
| Total insurance operations | | | | | |
| note (i) | 1,052 | 1,003 | 907 | 5% | 16% |
| Development expenses | (2) | (2) | (2) | 0% | 0% |
| Total long-term business operating profit | 1,050 | 1,001 | 905 | 5% | 16% |
| Eastspring Investments | 90 | 74 | 68 | 22% | 32% |
| Total Asia operations | 1,140 | 1,075 | 973 | 6% | 17% |

Notes

(i)

Analysis of operating profit between new and in-force business

The result for insurance operations comprises amounts in respect of new business and business in-force as follows:

| | 2014 £m | 2013 £m | |
|------------------------------|---------|---------|------|
| | | AER | CER |
| New business strain* | (18) | (15) | (18) |
| Business in force | 1,021 | 974 | 884 |
| Non-recurrent itemsnote (ii) | 49 | 44 | 41 |
| Total | 1,052 | 1,003 | 907 |

* The IFRS new business strain corresponds to approximately 1 per cent of new business APE premiums for 2014 (2013: approximately 1 per cent of new business APE).

The strain reflects the aggregate of the pre-tax regulatory basis strain to net worth after IFRS adjustments for deferral of acquisition costs and deferred income where appropriate.

(ii) Other non-recurrent items of £49 million in 2014 (2013: £44 million) represent a number of items none of which are individually significant that are not anticipated to re-occur in future.

I(c) Analysis of asset management operating profit based on longer-term investment returns

| | 2014 £m | | | | |
|--------------------------------------------------|-----------|-------------|--------|-----|-------|
| | M&G | Eastspring | PruCap | US | Total |
| | note (ii) | Investments | | | |
| | | note (ii) | | | |
| Operating income before performance-related fees | 954 | 240 | 130 | 303 | 1,627 |
| Performance-related fees | 33 | 1 | - | - | 34 |
| Operating income(net of commission)note (i) | 987 | 241 | 130 | 303 | 1661 |

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|----------------------------------------------------------|----------|---------|------|-------|---------|
| Operating expense note (i) | (554) | (140) | (88) | (291) | (1,073) |
| Share of associate's results | 13 | - | - | - | 13 |
| Group's share of tax on joint ventures' operating profit | - | (11) | - | - | (11) |
| Operating profit based on longer-term investment returns | 446 | 90 | 42 | 12 | 590 |
| Average funds under management | £250.0bn | £68.8bn | | | |
| Margin based on operating income* | 38bps | 35bps | | | |
| Cost / income ratio** | 58% | 59% | | | |

| | 2013 £m | | | | |
|----------------------------------------------------------|---------------|----------------------------------------|--------|-------|---------|
| | M&G note (ii) | Eastspring Investments note (ii),(iii) | PruCap | US | Total |
| Operating income before performance-related fees | 863 | 215 | 121 | 362 | 1,561 |
| Performance-related fees | 25 | 1 | - | - | 26 |
| Operating income (net of commission) note (i) | 888 | 216 | 121 | 362 | 1,587 |
| Operating expense note (i) | (505) | (134) | (75) | (303) | (1,017) |
| Share of associate's results | 12 | - | - | - | 12 |
| Group's share of tax on joint ventures' operating profit | - | (8) | - | - | (8) |
| Operating profit based on longer-term investment returns | 395 | 74 | 46 | 59 | 574 |
| Average funds under management | £233.8 bn | £61.9 bn | | | |
| Margin based on operating income* | 37 bps | 35 bps | | | |
| Cost / income ratio** | 59% | 62% | | | |

(i) Operating income and expense includes the Group's share of contribution from Joint Ventures (but excludes any contribution from associates). In the income statement as shown in note B2 of the IFRS financial statements, these amounts are netted and tax deducted and shown as a single amount.

(ii) M&G and Eastspring Investments can be further analysed as follows:

| | M&G | | | | | | Eastspring Investments | | | | | | |
|------|--------------------------------------------------|-----|-------------------------------|-----|-------------------------------------|-----|--------------------------------------------------|-----|-------------------------------|-----|-------------------------------------|-----|----|
| | Operating income before performance related fees | | | | | | Operating income before performance related fees | | | | | | |
| | Margin of Institutional+ Retail FUM* | | Margin of Institutional+ FUM* | | Margin of Institutional+ Total FUM* | | Margin of Institutional+ Retail FUM* | | Margin of Institutional+ FUM* | | Margin of Institutional+ Total FUM* | | |
| | £m | bps | £m | bps | £m | bps | £m | bps | £m | bps | £m | bps | |
| 2014 | 593 | 84 | 361 | 20 | 954 | 38 | 2014 | 139 | 60 | 101 | 22 | 240 | 35 |
| 2013 | 550 | 89 | 313 | 18 | 863 | 37 | 2013 | 127 | 60 | 88 | 22 | 215 | 35 |

* Margin represents operating income before performance related fees as a proportion of the related funds under management (FUM). Monthly closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group's insurance operations which are managed by third parties outside of the Prudential Group are excluded from these amounts.

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

† Institutional includes internal funds.

II Other Information

II(a) Holding company cash flow

| | 2014 £m | 2013 £m |
|--------------------------------------------------------------------|---------|---------|
| Net cash remitted by business units: | | |
| UK net remittances to the Group | | |
| UK Life fund paid to the Group | 193 | 206 |
| Shareholder-backed business: | | |
| Other UK paid to the Group | 132 | 149 |
| Total shareholder-backed business | 132 | 149 |
| Total UK net remittances to the Group | 325 | 355 |
| US remittances to the Group | 415 | 294 |
| Asia net remittances to the Group | | |
| Asia paid to the Group: | | |
| Long-term business | 453 | 454 |
| Other operations | 60 | 56 |
| | 513 | 510 |
| Group invested in Asia: | | |
| Long-term business | (3) | (9) |
| Other operations (including funding of Regional Head Office costs) | (110) | (101) |
| | (113) | (110) |
| Total Asia net remittances to the Group | 400 | 400 |
| M&G remittances to the Group | 285 | 235 |
| PruCap remittances to the Group | 57 | 57 |
| Net remittances to the Group from Business Units | 1,482 | 1,341 |
| Net interest paid | (335) | (300) |
| Tax received | 198 | 202 |
| Corporate activities | (193) | (185) |
| Solvency II costs | (23) | (32) |
| Total central outflows | (353) | (315) |
| Operating holding company cash flow before dividend* | 1,129 | 1,026 |
| Dividend paid | (895) | (781) |
| Operating holding company cash flow after dividend* | 234 | 245 |
| Non-operating net cash flow** | (978) | 613 |
| Total holding company cash flow | (744) | 858 |

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| | | |
|------------------------------------------------------|-------|-------|
| Cash and short-term investments at beginning of year | 2,230 | 1,380 |
| Foreign exchange movements | (6) | (8) |
| Cash and short-term investments at end of year | 1,480 | 2,230 |

* Including central finance subsidiaries.

**Non-operating net cash flow is principally for corporate transactions for distribution rights and acquired subsidiaries and issue and repayment of subordinated debt.

II(b) Funds under management

(a) Summary

| | 2014 £bn | 2013 £bn |
|--------------------------------------------------|----------|----------|
| Business area: | | |
| Asia operations | 49.0 | 38.0 |
| US operations | 123.6 | 104.3 |
| UK operations | 169.0 | 157.3 |
| Prudential Group funds under management note (i) | 341.6 | 299.6 |
| External funds note (ii) | 154.3 | 143.3 |
| Total funds under management | 495.9 | 442.9 |

Notes

(i) Prudential Group funds under management of £341.6 billion (2013: £299.6 billion) comprise:

| | 2014 £bn | 2013 £bn |
|----------------------------------------------------------------------------------------------------------|----------|----------|
| Total investments per the consolidated statement of financial position | 337.4 | 296.4 |
| Less: investments in joint ventures and associates accounted for using the equity method | (1.0) | (0.8) |
| Investment properties which are held for sale or occupied by the Group (included in other IFRS captions) | 0.3 | 0.3 |
| Internally managed funds held in joint ventures | 4.9 | 3.7 |
| Prudential Group funds under management | 341.6 | 299.6 |

(ii) External funds shown above as at 31 December 2014 of £154.3 billion (2013: £143.3 billion) comprise £167.2 billion (2013: £148.2 billion) of funds managed by M&G and Eastspring Investments as shown in note (b) below less £12.9 billion (2013: £4.9 billion) that are classified within Prudential Group's funds. The £167.2 billion (2013: £148.2 billion) investment products comprise £162.4 billion (2013: £143.9 billion) plus Asia Money Market Funds of £4.8 billion (2013: £4.3 billion).

(b) Investment products - external funds under management

| | 2014 £m | | | 2013 £m | | |
|-------------------------------------------------|-----------------------------|----------|-------------|-----------------------------|----------|-------------|
| | Eastspring Investments note | M&G | Group total | Eastspring Investments note | M&G | Group total |
| 1 January | 22,222 | 125,989 | 148,211 | 21,634 | 111,868 | 133,502 |
| Market gross inflows | 82,440 | 38,017 | 120,457 | 74,206 | 40,832 | 115,038 |
| Redemptions | (77,001) | (30,930) | (107,931) | (72,111) | (31,342) | (103,453) |
| Market exchange translation and other movements | 2,472 | 3,971 | 6,443 | (1,507) | 4,631 | 3,124 |

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31 December 30,133 137,047 167,180 22,222 125,989 148,211

(c) M&G and Eastspring investments - total funds under management

| | Eastspring Investments | | M&G | |
|---------------------------------|------------------------|------------------|----------|----------|
| | 2014 £bn note | 2013 £bn note | 2014 £bn | 2013 £bn |
| External funds under management | 30.1 | 22.2 | 137.0 | 126.0 |
| Internal funds under management | 47.2 | 37.7 | 127.0 | 118.0 |
| Total funds under management | 77.3 | 59.9 | 264.0 | 244.0 |

Note

The external funds under management for Eastspring Investments include Asia Money Market Funds at 31 December 2014 of £4.8 billion (2013: £4.3 billion).

II(c) Development of economic capital

Overview

Over the last decade regulatory bodies across the European Union have been working on the development of a more risk sensitive solvency framework. Solvency II was developed with this objective in mind and following ratification of the Omnibus II Directive on 16 April 2014, it is expected to come into force on 1 January 2016. It will apply to all European based insurers including Prudential.

Solvency II adopts the concept of market consistency as a valuation framework for both assets and liabilities as well as a one year value at risk methodology (with certain modifications) for evaluating solvency. While the majority of assets held by insurers can be fair valued based on market observable prices (albeit such market based valuations can be distorted at times of market stress), the same is not true of insurance liabilities which are not traded in liquid markets. Solvency II seeks to create a proxy market value for insurance liabilities, by valuing best-estimate cash flows at market levels of risk-free interest rates and allowing for an additional risk margin to ensure these liabilities are sufficient to cover the amount another insurance company would be prepared to pay for these liabilities.

There are significant limitations with both (i) the notion that this market consistent approach to valuing assets and liabilities represents at all times the underlying economic reality, and (ii) the emphasis that Solvency II places on the fluctuation of these proxy market values over a one year timeframe. The business typically undertaken by life insurers is long-term in nature, with liability profiles that are matched by maturity with similarly termed assets. This is why appropriately risk managed insurers can tolerate and withstand significant investment market volatility. What is critical in the assessment of the viability of insurers is their ability to meet claims when they fall due, over many years, rather than whether they can meet a one-year test based on theoretical proxy market values.

Notwithstanding these limitations, Prudential has been working to implement the requirements of Solvency II in time for its adoption in 2016. The section that follows provides an update on our progress towards implementation of Solvency II, highlights ongoing areas of uncertainty and draws attention to aspects where our current approach may differ to the one that will be ultimately agreed with the Prudential Regulation Authority.

From our work to date and subject to these limitations, our estimated economic capital surplus, based on outputs from our Solvency II internal model, is £9.7 billion, equivalent to an economic capital ratio of 218 per cent. Further explanation of the underlying economic capital methodology and assumptions which underpin these results is set out in the sections below.

Economic capital position1

31 31
December December

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| | 2014 £bn | 2013 £bn |
|------------------------------|----------|----------|
| Available capital | 17.9 | 18.5 |
| Economic capital requirement | 8.2 | 7.2 |
| Surplus | 9.7 | 11.3 |
| Economic capital ratio | 218% | 257% |

1 Based on outputs from the Group's Solvency II internal model which has not been reviewed or approved by the Prudential Regulation Authority.

In a number of areas Prudential's Solvency II methodology and assumptions will need to evolve in response to policy development and regulatory interpretations. A number of working assumptions have been adopted at this stage, which remain subject to policy clarifications and continuing feedback from the Prudential Regulation Authority. The calibration of the matching adjustment for UK annuity liabilities is one such example, as are a range of other calibration issues which will remain unclear until our internal model is approved by the Prudential Regulation Authority. Other areas where supervisory judgement and approval will be required include the proportion of Jackson's excess capital that will be included in the total surplus (under the deduction and aggregation approach) and the extent to which the economic capital surplus of our Asia operations will be recognised under the Solvency II fungibility tests. Against this backdrop of uncertainty it is expected that the Solvency II outcome will result in a lower ratio than the economic capital ratio above.

As an indication of the range of uncertainty, we have produced the following sensitivities to reflect various possible Solvency II outcomes. For example, relative to the £9.7 billion of economic capital surplus at 31 December 2014:

- A 20 per cent haircut in the contribution recognised for Asia in the Group available capital, reflecting Solvency II fungibility tests, would reduce Group surplus by £1.9 billion (-23 percentage points of cover ratio);
- Transitional relief may be applied in relation to the UK business, which subject to regulatory approval is expected to bring overall UK surplus in line with current Solvency I (Pillar II) levels. Applying this transitional relief for UK annuities is estimated to increase Group surplus by £1.3 billion (+16 percentage points of cover ratio); and
- A 10 per cent increase in UK annuity credit and longevity capital requirements (reflecting adverse matching adjustment outcomes or calibration strengthening) is estimated to reduce Group surplus by £0.6 billion (-12 percentage points of cover ratio). However, in this case the impact of transitional relief would be expected to increase as an offset to these changes.

These sensitivities are intended to provide examples and should not be considered indicative of the adjustments that the Prudential Regulation Authority may ultimately require.

Alongside developing the above economic capital based on outputs from our Solvency II internal model, we have developed an alternative 'multi-term' economic capital model, which seeks to evaluate our ability to meet obligations to customers as these fall due and which in our view is the best way to assess our economic solvency. This 'multi-term' approach is designed to both overcome the artificial one year timeframe of the Solvency II methodology and remove areas of known excessive prudence that for us do not reflect economic reality, such as the imposition of an additional risk margin that a theoretical buyer may demand to take over the liabilities in one year's time. Removing this risk margin alone would increase the estimated surplus referred to above to £13.6 billion, equivalent to an economic capital ratio of 265 per cent. This confirms the strong capital position of the Group and its ability to withstand severe market shocks, when assessed through appropriately risk-sensitive measures.

Detail relating to the economic capital position - based on outputs from our Solvency II internal model
Our economic capital results are based on outputs from our Solvency II internal model. Although the Solvency II and Omnibus II Directives, together with the Level 2 'Delegated Act' published on 17 January 2015, provide a framework

for the calculation of Solvency II results, there remain material areas of policy uncertainty and the methodology and assumptions are subject to review and approval by the Prudential Regulation Authority, the Group's lead supervisor.

We remain on track to submit our internal model to the Prudential Regulation Authority for approval in 2015. However, given the degree of uncertainty, these economic capital results should not be interpreted as representing the Pillar I output from an approved Solvency II internal model and are not intended to provide a forecast of the eventual position.

At 31 December 2014, the Group had an economic capital surplus of £9.7 billion (2013: £11.3 billion) and an economic capital ratio of 218 per cent before taking into account the 2014 final dividend. A summary of the capital position on this basis is shown in the table below:

| | 31 December 2014 £bn | 31 December 2013 £bn |
|----------------------------------------|----------------------------|----------------------------|
| Economic capital position ¹ | | |
| Available capital | 17.9 | 18.5 |
| Economic capital requirement | 8.2 | 7.2 |
| Surplus | 9.7 | 11.3 |
| Economic capital ratio | 218% | 257% |

¹ Based on outputs from the Group's Solvency II internal model which has not been reviewed or approved by the Prudential Regulation Authority.

The economic capital results are based on outputs from our current Solvency II internal model with a number of working assumptions. Further explanation of the underlying methodology and assumptions are set out in the sections below. Certain aspects of this methodology and assumptions will differ from those which are applied in obtaining final internal model approval. Consequently, the position is expected to evolve to reflect policy clarifications and feedback from the Prudential Regulation Authority on Prudential's approach to applying this new regime. Against this background of uncertainty, it is expected that the Solvency II ratio based on an approved model will be lower than the position shown above.

Methodology

In line with Solvency II, for the Group's European and Asia life business, and holding companies, the available capital is the value of assets in excess of liabilities. The key components of available capital are the market value of assets, insurance technical provisions (calculated as the sum of best estimate liabilities plus a risk margin) and other liabilities. Subordinated-debt forms part of available capital, rather than being treated as a liability, since this debt is subordinated to policyholder claims.

As a general principle, both assets and liabilities are recognised at the value at which they could theoretically be transferred to a third party in an arm's length transaction. On the asset side of the balance sheet, assets are mostly held at IFRS fair value. However, adjustments are required to IFRS values to eliminate intangible items such as goodwill and deferred acquisition costs and to take account of economic assets which are excluded from the current IFRS balance sheet such as the present value of future with-profits shareholder transfers.

The best estimate liability is calculated by taking the average of future risk-adjusted best estimate cashflows, taking into account the time value of money. An economic definition of contract boundaries has been applied in determining the cashflows to include in the best estimate liability. The best estimate liability also allows for the value of options and guarantees embedded in existing contracts as well as the value of future discretionary benefits payable to policyholders. Realistic management actions and policyholder behaviour are allowed for where relevant. In addition, since capital requirements are only derived to cover risks over a one year horizon, a risk margin is added to the best estimate liability to cover the cost of ceding liabilities to a third party after one year, assuming a 6 per cent per annum

cost of capital and with no diversification between legal entities, in line with Solvency II requirements.

The Economic Capital Requirement measures the potential reduction in the value of available capital over a one year time horizon, in an adverse 1-in-200 probability event, consistently with Solvency II. This allows for diversification effects between different risk-types and between entities. No restrictions on the economic value of overseas surplus have been allowed for in assessing the capital position at Group level, reflecting our view that in an economic capital assessment, haircuts for transferability restrictions are artificial.

Prudential's US insurance entities are included in the economic capital position on a local RBC basis under the assumption of US equivalence and the assumed permitted use of the 'deduction and aggregation' method. This is in line with our view of the most likely outcome of Solvency II given the agreement reached in the Omnibus II Directive. The contribution of US insurance entities to the Group surplus is that in excess of 250 per cent of the US RBC Company Action Level, which is in line with the level at which we measure both the Group's IGD surplus and the Group's reported free surplus amount. In line with Solvency II requirements under the 'deduction and aggregation' method, no diversification benefit is allowed for between US insurance entities and other parts of the Group.

The Group calculation also includes all non-insurance entities, including asset management companies, Prudential Capital and holding companies, as follows:

- Asset managers are included in line with existing sectoral capital rules, and Prudential Capital is included on a Basel basis, which follows the expected Solvency II treatment;
- Defined benefit pension schemes are included using international accounting standards and, in addition, a capital requirement is derived from stressing the accounting position; and
- Holding companies are measured on a Solvency II basis, as if they were insurance companies, in line with Solvency II rules.

In addition to the assumption of US equivalence, no transferability restrictions have been applied to the economic value of overseas surplus. Other key elements of Prudential's methodology relating to areas that are presently unclear for Solvency II Pillar I calculations, relate to:

- (i) The liability discount rate for UK annuities, which includes an initial estimate of the Solvency II 'matching adjustment' in addition to the risk-free rate, but where there remains a range of possible outcomes pending further policy clarity;
- (ii) The impact of transitional arrangements on technical provisions, for which no allowance has been made in the economic capital position, but which may apply under Solvency II (although the use of this transitional is subject to regulatory approval and the extent to which it is permitted is likely to depend on the final Solvency II capital position); and
- (iii) Capital requirements for currency translation impacts, arising from overseas capital (supporting non-UK subsidiaries) being measured in sterling at potentially stressed exchange rates. This impact is not currently allowed for, reflecting our view that an economic capital exposure only arises where funds need to be transferred between entities in order to cover a negative surplus position.

Further, Solvency II outcomes remain unclear in relation to the tiering of hybrid capital instruments, although tiering limits are not currently expected to result in any restrictions.

The 2013 results were prepared using a liquidity premium methodology, before the matching adjustment had been included in our internal model. Under this previous basis, credit reserves were set as a proportion of credit spreads. The 2013 results have not been restated for the effect of adopting the matching adjustment methodology, with the difference between the two approaches being recorded within the 2014 model changes.

Assumptions

The key assumptions required for the economic capital calibration are:

- (i) Assumptions used to derive non-market related best estimate liability cash flows, which are based on EEV best estimate assumptions;
- (ii) Assumptions used to derive market related best estimate liability cash flows, which are based on market data at the valuation date where this data is reliable and comes from a deep and liquid market, or on appropriate extrapolation methodologies where markets are not sufficiently liquid to be reliable;
- (iii) Assumptions underlying the calculation of the best estimate liability in respect of dynamic management actions and policyholder behaviour;
- (iv) Assumptions underlying the risk models used to calculate the 1-in-200 level capital requirements for the Economic Capital Requirement which are set using a combination of historic market, demographic and operating experience data and expert judgement; and
- (v) Assumptions on the dependencies between risks, which are calibrated using a combination of historic data and expert judgement.

The risk-free curve at which best estimate liability cash flows are discounted is based on market swap rates (with the exception of Vietnam, India and Poland where no liquid swap market exists and government bond yields are therefore used), with a deduction of between 10 and 35 basis points (depending on country) to allow for a 'credit risk adjustment' to swap rates. This treatment reflects the likely outcome under Solvency II. In addition, an estimated matching adjustment is added to the liability discount rate for UK annuities, in both the base balance sheet and in the stressed conditions underlying the Economic Capital Requirement.

The matching adjustment is set equal to the yield on the backing-assets in each portfolio, less deductions for credit risk, cashflow mismatch allowances and haircuts for assets assumed to be ineligible for the matching adjustment (currently around 10 per cent of shareholder-backed annuity assets). Full allowance has been made for diversification benefits between the matching adjustment portfolio and other funds, reflecting an economic treatment. These assumed deductions from the portfolio yield are summarised in the table below. However, the final Solvency II matching adjustment outcome remains subject to considerable uncertainties and may vary significantly from these assumptions.

| | Base bps | Post 1-in 200 stress undiversified bps |
|-------------------------------------------------|----------|-------------------------------------------|
| Credit allowances deducted from asset yields | | |
| UK shareholder-backed annuities | 71 | 172 |

Aside from UK annuities, no matching adjustment allowance or any other form of liquidity premium has been assumed for any other lines of business.

Other business developments

On 5 February 2015 Prudential announced the completion of the sale of its closed book business in Japan. The contribution of Japan to the Group surplus has been set equal to the 'held for sale' accounting value of £49 million. On 10 November 2014, Prudential announced an agreement to sell its 25 per cent equity stake in the PruHealth and PruProtect businesses for £155 million, which is allowed for in these results. On 1 July 2014 Prudential renewed its distribution agreement with Standard Chartered Bank to 2029. The amount of these distribution fees is allowed for in

these economic capital results and has had a negative impact on the Group solvency ratio of -10 percentage points. The impact of the domestication of the Hong Kong branch, which became effective on 1 January 2014, is also allowed for and is estimated to have had a negative impact on the Group solvency ratio of -4 percentage points, mainly due to a loss of diversification in the risk margin following separation of the Hong Kong business into a subsidiary.

Analysis of movement in the economic capital surplus

The table below shows the movement during the financial year in the Group's economic capital surplus.

Analysis of movement in economic capital surplus¹ from 1 January to 31 December

| (£ billion) | 2014 | 2013 |
|-------------------------------------------------------|-------|-------|
| Economic capital surplus as at 1 January | 11.3 | 8.8 |
| Operating experience | 1.8 | 2.1 |
| Non-operating experience (including market movements) | (0.9) | 0.9 |
| Other capital movements | | |
| Disposals | 0.1 | (0.1) |
| Corporate restructuring | (0.3) | - |
| Distribution deals | (0.8) | (0.4) |
| Subordinated debt issuance / (redemption) | (0.4) | 1.1 |
| Foreign currency translation impacts | 0.1 | (0.4) |
| Dividends | (0.9) | (0.8) |
| Model changes | (0.3) | 0.1 |
| Economic capital surplus as at 31 December | 9.7 | 11.3 |

¹ Based on outputs from the Group's Solvency II internal model which has not been reviewed or approved by the Prudential Regulation Authority.

During 2014 the movement in the Group economic surplus is driven by:

- Operating experience: generated by in-force business, new business written in 2014, the impact of non-market assumption changes and non-market experience variances over the year. The 2013 operating experience result additionally benefited from specific de-risking actions which were not repeated given the Group's overall economic capital strength;
- Non-operating experience: mainly arising from negative market experience during 2014, principally caused by the reduction in long-term interest rates in the UK;
- Other capital movements: a reduction in surplus from the repayment of subordinated debt, renewal of the bancassurance partnership agreement with Standard Chartered Bank, the negative capital effect of the domestication of the Hong Kong branch, an increase in surplus from the sale of the PruHealth and PruProtect businesses, positive foreign currency translation effects, and a reduction in surplus due to dividend payments in 2014; and
- Model changes: a negative impact to Group surplus for the estimated impact of evolving the liability discount rate for UK shareholder-backed annuity business from one based on a liquidity premium to one based on the matching adjustment, and other internal model refinements.

Analysis of Group Economic Capital Requirements

The table below shows the split of the Group Economic Capital Requirement by risk type¹.

| 31 December 2014 | | 31 December 2013 | |
|--------------------------------------------------------------|------------------------------------------------------------|--------------------------------------------------------------|------------------------------------------------------------|
| % of undiversified Economic Capital Requirement ² | % of diversified Economic Capital Requirement ² | % of undiversified Economic Capital Requirement ² | % of diversified Economic Capital Requirement ² |
| | | | |

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| | | | | |
|-------------------------|-----|-----|-----|-----|
| Market | 57% | 66% | 53% | 64% |
| Equity | 15% | 21% | 15% | 24% |
| Credit | 26% | 39% | 20% | 37% |
| Yields (interest rates) | 12% | 4% | 13% | 0% |
| Other | 4% | 2% | 5% | 3% |
| Insurance | 33% | 27% | 36% | 28% |
| Mortality/morbidity | 6% | 3% | 8% | 4% |
| Lapse | 16% | 19% | 19% | 21% |
| Longevity | 11% | 5% | 9% | 3% |
| Operational/expense | 10% | 7% | 11% | 8% |

1 The Group Economic Capital Requirement by risk type includes capital requirements in respect of Jackson's risk exposures, based on 250 per cent of the US RBC Company Action Level.

2 Based on outputs from the Group's Solvency II internal model which has not been reviewed or approved by the Prudential Regulation Authority.

The Group's most material risk exposures are to financial markets, in particular to equities and credit, which we hold to generate a higher return on capital and a higher return for our policyholders over the long-term. The Group also has material insurance risk exposures including longevity risk from UK annuities, lapse risk across a wide range of products, and mortality and morbidity risk mainly arising from protection products written in Asia. These risks diversify strongly with market risks, even after allowing for market-related policyholder behaviour, thereby increasing the return on capital which can be earned from the balanced mix of risks. A brief description of the most material risks is set out below:

- The Group's exposure to equities mainly arises from UK shareholder transfers linked to policyholder funds (partially offset by economic equity hedges) and from future fund management charges on unit linked funds in Asia. The equity exposure arising from Jackson's variable annuity business is mostly hedged;
- The Group also has significant exposure to credit risk, mainly from the UK annuity portfolio and from Jackson's fixed annuity credit portfolio. Credit exposures across the Group are carefully monitored and managed as part of the Group's risk management framework;
- The Group is exposed to movements in yields (interest rates); while falling interest rates increase the risks arising from policyholder guarantees in with-profits funds and variable annuities, falling interest rates also increase the value of future insurance profits;
- The most material insurance risk exposures arise from UK longevity risk, and lapse, mortality and morbidity risk in Asia; and
- The Group is also exposed to expense and operational risk, which is closely monitored and managed through internal control processes.

Reconciliation of IFRS equity to economic available capital

To aid understanding, the amount representing the Group's available capital under the economic capital basis is reconciled to the Group's IFRS shareholders' equity in the table below:

Reconciliation of IFRS equity to economic available capital

| | | |
|------------------------------------------|------|------|
| £ billion ¹ | 2014 | 2013 |
| IFRS shareholders' equity at 31 December | 11.8 | 9.7 |

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| | | |
|------------------------------------------------------------------------------------------------|-------|-------|
| Adjustment to restate US insurance entities onto a US Risk Based Capital basis | (1.1) | (0.6) |
| Remove DAC, goodwill & intangibles | (3.5) | (2.7) |
| Add subordinated-debt treated as economic available capital | 3.7 | 3.8 |
| Impact of risk margin | (4.7) | (3.5) |
| Add value of shareholder-transfers | 4.0 | 4.1 |
| Other liability valuation differences | 9.0 | 9.3 |
| Increase in value of net deferred tax liabilities (resulting from valuation differences above) | (0.9) | (1.3) |
| Other | (0.4) | (0.3) |
| Economic available capital at 31 December | 17.9 | 18.5 |

1 Based on outputs from the Group's Solvency II internal model which has not been reviewed or approved by the Prudential Regulation Authority.

The key items of reconciliation are:

- £1.1 billion (2013: £0.6 billion) represents the adjustment required to the Group's shareholders' funds in order to convert Jackson's contribution from an IFRS basis to the local statutory valuation basis which underpins the US Risk Based Capital regime;
- £3.5 billion (2013: £2.7 billion) due to the removal of DAC, goodwill and intangibles from the IFRS balance sheet;
- £3.7 billion (2013: £3.8 billion) due to the addition of subordinated debt which is treated as available capital on an economic basis but as a liability under IFRS;
- £4.7 billion (2013: £3.5 billion) due to the inclusion of a risk margin which is not required under IFRS;
- £4.0 billion (2013: £4.1 billion) due to the inclusion of the value of future shareholder transfers from with-profits business on the economic balance sheet in the UK and Asia, which is excluded from the determination of the Group's IFRS shareholders' funds;
- £9.0 billion (2013: £9.3 billion) due to differences in insurance valuation requirements between economic capital and IFRS, with available capital partially capturing the economic value of in-force business which is excluded from IFRS; and
- £0.9 billion (2013: £1.3 billion) due to the impact on the valuation of deferred tax assets and liabilities resulting from the other valuation differences noted above.

Sensitivity analysis

Stress testing this economic capital position gives the following results as at 31 December 2014:

- An instantaneous 20 per cent fall in equity markets would reduce surplus by £0.6 billion and reduce the economic solvency ratio to 214 per cent;
- An instantaneous 40 per cent fall in equity markets would reduce surplus by £2.2 billion and reduce the economic solvency ratio to 195 per cent;
- A 50 basis points reduction in interest rates (subject to a floor of zero) would reduce surplus by £1.4 billion and reduce the economic solvency ratio to 195 per cent;
- A 100 basis points increase in interest rates would increase surplus by £1.8 billion and increase the economic solvency ratio to 254 per cent; and
- A 100 basis points increase in credit spreads with 15 per cent downgrades in the UK annuity portfolio would reduce surplus by £2.1 billion and reduce the economic solvency ratio to 190 per cent.

These sensitivity results are shown before the impact of potential management actions to de-risk the exposures of shareholder funds. Even before such management actions are allowed for, the results demonstrate the resilience of the economic capital position following large falls in equity markets, sizeable reductions in yields (relative to very low starting yields) and a severe credit event.

The adverse impact of falling equity markets mainly results from a reduction in the value of with-profits shareholder transfers and future fund management charges in the UK and Asia. Equity hedging reduces the impact of these exposures and a dynamic equity hedging programme is also in place to manage the equity risk arising in Jackson's

variable annuities business.

The adverse impact of a fall in yields largely arises from a decrease in the value of future with-profits shareholder transfers and an increase in the size of risk margins. Falling yields also increases the value of the Group's external debt, reducing the Group surplus. However, these impacts are partially offset by an increase in the value of future insurance profits and changes in the value of hedging assets.

An increase in defaults and downgrades adversely impacts on the UK annuity credit book although the business is much less sensitive to credit spreads under the matching adjustment framework. Jackson is not exposed to credit spread widening on a US RBC basis but an increase in defaults in the Jackson credit book would have a negative impact on the Group capital position and is reflected in the credit stress test above.

1 For UK annuity business, the matching adjustment is intended to significantly reduce the sensitivity of surplus to credit spreads. The UK annuity credit sensitivity is therefore applied as 15 per cent of the portfolio downgrading, combined with a credit spread stress of 88 basis points (which in total is commensurate with a 100 basis point credit spread stress). For Jackson, a 10x increase in expected defaults is applied in line with IGD sensitivities since credit spreads do not directly affect the US RBC result.

Statement of independent review

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

SIGNATURES

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

Date: 10 March 2015

PRUDENTIAL PUBLIC LIMITED COMPANY

By: /s/Nic Nicandrou

Nic Nicandrou
Chief Financial Officer