PRUDENTIAL PLC
Form 6-K
March 09, 2011

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, 2011

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 X 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 X

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

Enclosures: Final Results part 4

European Embedded Value (EEV) basis results

Operating profit based on longer-term investment returnsi

Results analysis by business area

		Note	2010 £m	2009 £mv
Asian operations				
New business:				
	Excluding Japan	2	902	725
	Japaniv		(1)	(12)
	Total		901	713
Business in force		3	549	392
Long-term business			1,450	1,105
Asset management			72	55
Development expenses			(4)	(6)
Total			1,518	1,154
US operations				
New business		2	761	664
Business in force		3	697	569
Long-term business			1,458	1,233
Broker-dealer and asset management			22	4
Total			1,480	1,237
UK operations				
New business		2	365	230
Business in force		3	571	640
Long-term business			936	870
General insurance commission			46	51
Total UK insurance operations			982	921
M&G			284	238
Total			1,266	1,159
Other income and expenditure				
Investment return and other income			30	22
Interest payable on core structural borrowings			(257)	(209)
Corporate expenditure			(220)	(203)
Charge for share-based payments for Prudential schemes			(3)	(5)
Charge for expected asset management marginii			(44)	(38)
Total			(494)	(433)
Solvency II implementation costs iii			(46)	-
Restructuring costsiii			(28)	(27)
Operating profit based on longer-term investment returnsi			3,696	3,090
Analysed as profits (losses) from:				
New business:				
	Excluding Japan	2	2,028	1,619
	Japaniv		(1)	(12)
	Total		2,027	1,607
Business in force		3	1,817	1,601
Long-term business			3,844	3,208

Asset management	378	297
Other results	(526)	(415)
Total	3,696	3,090

Notes

i EEV basis operating profit based on longer-term investment returns excludes the recurrent items of short-term fluctuations in investment returns, the mark to market value movements on core borrowings, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, and the effect of changes in economic assumptions. In addition, for 2010, operating profit excludes costs associated with the terminated AIA transaction and the gain arising upon the dilution of the Group's holding in PruHealth. For 2009, operating profit excluded the non-recurrent cost of hedging the Group IGD capital surplus included within short-term fluctuations in investment returns and the profit on sale and results of the sold Taiwan agency business.

The amounts for these items are included in total EEV profit attributable to shareholders. The Company believes that operating profit, as adjusted for these items, better reflects underlying performance. Profit before tax and basic earnings per share include these items together with actual investment returns. This basis of presentation has been adopted consistently throughout these results.

ii The value of future profits or losses from asset management and service companies that support the Group's covered businesses are included in the profits for new business and the in-force value of the Group's long-term business. The results of the Group's asset management operations include the profits from management of internal and external funds. For EEV basis reporting, Group shareholders' other income is adjusted to deduct the expected margins for the period on management of covered business. The deduction is on a basis consistent with that used for projecting the results for covered business. Group operating profit accordingly includes the variance between actual and expected profit in respect of covered business.

iii Restructuring costs comprise the charge of £(26) million recognised on an IFRS basis and an additional £(2) million recognised on the EEV basis for the shareholders' share of restructuring costs incurred by the PAC with-profits fund (2009: £(23) million on an IFRS basis and an additional £(4) million on the EEV basis). For 2010, Solvency II implementation costs comprise the charge of £(45) million recognised on an IFRS basis and an additional £(1) million recognised on the EEV basis.

iv New business profits for the Group's Japanese insurance subsidiary, which ceased selling new business with effect from 15 February 2010, have been presented separately from those of the remainder of the Group.

v Exchange translation

The comparative results have been prepared using previously reported average exchange rates for the year.

Summarised consolidated income statement

		2010	2009
	Note	£m	£m
Operating profit based on longer-term investment returns			
Asian operations		1,518	1,154
US operations		1,480	1,237
UK operations:			
UK insurance operations		982	921
M&G		284	238
		1,266	1,159
Other income and expenditure		(494)	(433)
Solvency II implementation costs		(46)	-
Restructuring costs		(28)	(27)
Operating profit based on longer-term investment returns		3,696	3,090

Short-term fluctuations in investment returns	4	(30)	351
Mark to market value movements on core borrowings	9	(164)	(795)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes		(11)	(84)
Effect of changes in economic assumptions	5	(10)	(910)
Costs of terminated AIA transaction	6	(377)	-
Gain on dilution of holding in PruHealth	18	3	-
Profit on sale and results for Taiwan agency business	19	-	91
Profit from continuing operations before tax (including actual investment returns)		3,107	1,743
Tax attributable to shareholders' profit	11	(530)	(481)
Profit from continuing operations after tax before non-controlling interests		2,577	1,262
Discontinued operations (net of tax)		-	(14)
Profit for the year		2,577	1,248
Attributable to:			
Equity holders of the Company		2,573	1,245
Non-controlling interests		4	3
Profit for the year		2,577	1,248

Earnings per share (in pence)

	Note	2010	2009
From operating profit based on longer-term investment returns, after related tax and non-controlling interests of £2,700m* (2009: £2,221m)	12	106.9p	88.8p
Based on profit after tax and non-controlling interests of £2,573m (2009: £1,245m)	12	101.9p	49.8p

* excluding an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities - see note 11.

Dividends per share (in pence)

	2010	2009
Dividends relating to reporting year:		
Interim dividend (2010 and 2009)	6.61p	6.29p
Final/second interim dividend (2010 and 2009)	17.24p	13.56p
Total	23.85p	19.85p
Dividends declared and paid in reporting year:		
Current year interim dividend	6.61p	6.29p
Second interim/final dividend for prior year	13.56p	12.91p
Total	20.17p	19.20p

Movement in shareholders' equity (excluding non-controlling interests)

	Note	2010	2009

		£m	£m
Profit for the year attributable to equity shareholders		2,573	1,245
Items taken directly to equity:			
Exchange movements on foreign operations and net investment hedges:			
Exchange movements arising during the year		659	(761)
Related tax		34	11
Dividends		(511)	(481)
New share capital subscribed (including shares issued in lieu of cash dividends)		75	141
Reserve movements in respect of share-based payments		37	29
Treasury shares:			
Movement in own shares held in respect of share-based payment plans		(4)	3
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		3	(3)
Mark to market value movements on Jackson assets backing surplus and required capital (gross movement)		105	205
Related tax		(37)	(72)
Net increase in shareholders' equity	10	2,934	317
Shareholders' equity at beginning of year (excluding non-controlling interests)	7,10	15,273	14,956
Shareholders' equity at end of year (excluding non-controlling interests)	7,10	18,207	15,273

		2010 £m			2009 £m		
Comprising:	Note	Long-term business operations	Asset management and other operations	Total	Long-term business operations	Asset management and other operations	Total
Asian operations:							
Net assets of operations		7,445	197	7,642	5,781	161	5,942
Acquired goodwill		236	61	297	80	61	141
	7	7,681	258	7,939	5,861	222	6,083
US operations:							
Net assets of operations		4,799	106	4,905	4,122	95	4,217
Acquired goodwill		-	16	16	-	16	16
	7	4,799	122	4,921	4,122	111	4,233
UK insurance operations:							
Net assets of operations		5,970	33	6,003	5,439	37	5,476
M&G:							
Net assets of operations		-	254	254	-	173	173
Acquired goodwill		-	1,153	1,153	-	1,153	1,153
		-	1,407	1,407	-	1,326	1,326
	7	5,970	1,440	7,410	5,439	1,363	6,802
Other operations:							

Holding company net borrowings at market value	9	-	(2,212)	(2,212)	-	(1,780)	(1,780)
Other net assets (liabilities)		-	149	149	-	(65)	(65)
	7	-	(2,063)	(2,063)	-	(1,845)	(1,845)
Shareholders' equity at end of year (excluding non-controlling interests)	7	18,450	(243)	18,207	15,422	(149)	15,273
Representing:							
Net assets		18,214	(1,473)	16,741	15,342	(1,379)	13,963
Acquired goodwill		236	1,230	1,466	80	1,230	1,310
		18,450	(243)	18,207	15,422	(149)	15,273

Net asset value per share (in pence)	2010	2009
Based on EEV basis shareholders' equity of £18,207 million (2009: £15,273 million)	715p	603p
Number of issued shares at year end (millions)	2,546	2,532
Return on embedded value*	18%	15%

* Return on embedded value is based on EEV operating profit after tax and non-controlling interests (adjusted to exclude an exceptional tax credit of £158 million (as shown in note 11) as a percentage of opening EEV basis shareholders' equity.

Summary statement of financial position

	Note	2010 £m	2009 £m
Total assets less liabilities, before deduction for insurance funds		231,667	201,501
Less insurance funds:*			
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds		(223,636)	(195,230)
Less shareholders' accrued interest in the long-term business		10,176	9,002
		(213,460)	(186,228)
Total net assets	7,10	18,207	15,273
Share capital		127	127
Share premium		1,856	1,843
IFRS basis shareholders' reserves		6,048	4,301
Total IFRS basis shareholders' equity	7	8,031	6,271
Additional EEV basis retained profit	7	10,176	9,002
Shareholders' equity (excluding non-controlling interests)	7,10	18,207	15,273

*Including liabilities in respect of insurance products classified as investment contracts under IFRS 4.

Notes on the EEV basis result

1 Basis of preparation, methodology and accounting presentation

The EEV basis results have been prepared in accordance with the EEV Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005. Where appropriate, the EEV basis results include the effects of adoption of International Financial Reporting Standards (IFRS).

The directors are responsible for the preparation of the supplementary information in accordance with the EEV Principles.

The EEV basis results for 2010 and 2009 have been derived from the EEV basis results supplement to the Company's statutory accounts for 2010. The supplement included an unqualified audit report from the auditors.

a Covered business

The EEV results for the Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Group's long-term insurance business for which the value of new and in-force contracts is attributable to shareholders. The EEV basis results for the Group's covered business are then combined with the IFRS basis results of the Group's other operations.

The definition of long-term business operations is consistent with previous practice and comprises those contracts falling under the definition of long-term insurance business for regulatory purposes together with, for US operations, contracts that are in substance the same as guaranteed investment contracts (GICs) but do not fall within the technical definition. Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management.

With two principal exceptions, covered business comprises the Group's long-term business operations. The principal exceptions are for the closed Scottish Amicable Insurance Fund (SAIF) and for the presentational treatment of the financial position of the Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS). A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

SAIF is a ring-fenced sub-fund of the Prudential Assurance Company (PAC) long-term fund, established by a Court approved Scheme of Arrangement in October 1997. SAIF is closed to new business and the assets and liabilities of the fund are wholly attributable to the policyholders of the fund.

As regards PSPS, the deficit funding liability attaching to the shareholder-backed business is included in the total for Other operations, reflecting the fact that the deficit funding is being paid for by the parent company, Prudential plc.

b Methodology

i Embedded value

Overview

The embedded value is the present value of the shareholders' interest in the earnings distributable from assets allocated to covered business after sufficient allowance has been made for the aggregate risks in that business. The shareholders' interest in the Group's long-term business comprises:

- present value of future shareholder cash flows from in-force covered business (value of in-force business), less deductions for:
    - the cost of locked-in required capital;
    - the time value of cost of options and guarantees
- locked-in required capital; and
- shareholders' net worth in excess of required capital (free surplus).

The value of future new business is excluded from the embedded value.

Notwithstanding the basis of presentation of results (as explained in note 1c(iv)) no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or profit before tax. Separately, the analysis of profit is delineated between operating profit based on longer-term investment returns and other constituent items, as explained in note 1c(i).

Valuation of in-force and new business

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency and mortality. These assumptions are used to project future cash flows. The present value of the future cash flows is then calculated using a discount rate which reflects both the time value of money and the non-diversifiable risks associated with the cash flows that are not otherwise allowed for.

Best estimate assumptions

Best estimate assumptions are used for the cash flow projections, where best estimate is defined as the mean of the distribution of future possible outcomes. The assumptions are reviewed actively and changes are made when evidence exists that material changes in future experience are reasonably certain.

Assumptions required in the calculation of the value of options and guarantees, for example relating to volatilities and correlations, or dynamic algorithms linking liabilities to assets, have been set equal to the best estimates and, wherever material and practical, reflect any dynamic relationships between the assumptions and the stochastic variables.

Principal economic assumptions

For the Group's UK and US operations, the 2010 and 2009 EEV basis results have been determined using economic assumptions where the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on cash or fixed income securities (the 'active' basis).

For Asian operations, the 2009 EEV basis results for Japan, Korea and US dollar denominated business written in Hong Kong were determined on the 'active' basis. For other Asian countries the investment return assumptions and risk discount rates for 2009 were based on an assessment of longer-term economic conditions (the 'passive' basis). In 2010, the approach has been altered to determine the EEV basis results for all Asian territories on an active basis of economic assumption setting, in line with the Group's other operations, and reflecting the fact that markets in a number of Asian countries are becoming increasingly developed.

For those Asian operations whose EEV basis results were previously determined on the 'passive' basis of economic assumption setting, the effect of the change in 2010 to move to an 'active' basis is as follows:

	£m
Pre-tax operating profits from:	
New business (note 2)	5
Business in-force (note 3)	(58)
Total	(53)
Effect on short-term fluctuations in investment returns and changes in economic assumptions	16
Total profit before tax	(37)
Shareholders' funds as at 31 December 2010	(39)

For 2010 and 2009, for all the Group's operations, expected returns on equity and property asset classes are derived by adding a risk premium, based on the long-term view of Prudential's economists to the risk free rate.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same as that calculated under the IFRS basis. Since the embedded value basis reflects discounted future cash flows, under this methodology the profit emergence is advanced thus more closely aligning the timing of the recognition of profits with the efforts and risks of current management actions, particularly with regard to business sold during the year.

New Business

The contribution from new business represents profits determined by applying operating assumptions as at the end of the year.

In determining the new business contribution for UK immediate annuity and lifetime mortgage business, which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business is priced. For other business within the Group, end of period economic assumptions are used.

Valuation movements on investments

With the exception of debt securities held by Jackson, investment gains and losses during the year (to the extent that changes in capital values do not directly match changes in liabilities) are included directly in the profit for the year and shareholders' equity as they arise.

The results for any covered business conceptually reflects the aggregate of the IFRS results and the movements on the additional shareholders' interest recognised on the EEV basis. Thus the start point for the calculation of the EEV results for Jackson, as for other businesses, reflects the market value movements recognised on the IFRS basis.

However, in determining the movements on the additional shareholders' interest, the basis for calculating the Jackson EEV result acknowledges that for debt securities backing liabilities the aggregate EEV results reflect the fact that the value of in-force business instead incorporates the discounted value of future spread earnings. This value is not affected generally by short-term market movements on securities that are broadly speaking held for the longer-term.

Fixed income securities backing the free surplus and required capital for Jackson are accounted for at fair value. However, consistent with the treatment applied under IFRS for Jackson securities classified as available-for-sale, movements in unrealised appreciation on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

Cost of capital

A charge is deducted from the embedded value for the cost of capital supporting the Group's long-term business. This capital is referred to as required capital. The cost is the difference between the nominal value of the capital and the discounted value of the projected releases of this capital allowing for investment earnings (net of tax) on the capital.

The annual result is affected by the movement in this cost from year-to-year which comprises a charge against new business profit and generally a release in respect of the reduction in capital requirements for business in force as this runs off.

Where required capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its release over time and no further adjustment is necessary in respect of required capital.

Financial options and guarantees

Nature of options and guarantees in Prudential's long-term business

Asian operations

Subject to local market circumstances and regulatory requirements, the guarantee features described below in respect of UK business broadly apply to similar types of participating contracts principally written in the PAC Hong Kong branch, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

Non-participating long-term products are the only ones where the insurer is contractually obliged to provide guarantees on all benefits. Whole of life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequent with market conditions are written in the Korean life operations and also are a feature of the UOB in-force book acquired in 2010. The amounts of these policies written in these operations are much smaller than the amounts of similar policies written by the Taiwan Life business which was sold in the first half of 2009, as detailed in note 19.

US operations (Jackson)

The principal options and guarantees in Jackson are associated with the fixed annuity and Variable Annuity (VA) lines of business.

Fixed annuities provide that, at Jackson's discretion, it may reset the interest rate credited to policyholders' accounts, subject to a guaranteed minimum. The guaranteed minimum return varies from 1.5 per cent to 5.5 per cent (2009: 1.5 per cent to 5.5 per cent), depending on the particular product, jurisdiction where issued, and date of issue.

At 31 December 2010, 83 per cent (2009: 82 per cent) of the account values on fixed annuities relates to policies with guarantees of 3 per cent or less. The average guarantee rate is 2.9 per cent (2009: 3.0 per cent).

Fixed annuities also present a risk that policyholders will exercise their option to surrender their contracts in periods of rapidly rising interest rates, possibly requiring Jackson to liquidate assets at an inopportune time.

Jackson issues VA contracts where it contractually guarantees to the contract holder either: a) return of no less than total deposits made to the contract adjusted for any partial withdrawals, b) total deposits made to the contract adjusted for any partial withdrawals plus a minimum return, or c) the highest contract value on a specified anniversary date adjusted for any withdrawals following the specified contract anniversary. These guarantees include benefits that are payable at specified dates during the accumulation period (Guaranteed Minimum Withdrawal Benefit (GMWB)), as death benefits (Guaranteed Minimum Death Benefits (GMDB)) or as income benefits (Guaranteed Minimum Income Benefits (GMIB)). Jackson reinsures and hedges these risks using equity options and futures contracts. These guarantees generally protect the policyholder's value in the event of poor equity market performance.

Jackson also issues fixed index annuities that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns would be of a similar nature to those described above for fixed annuities.

UK insurance operations

The only significant financial options and guarantees in the UK insurance operations arise in the with-profits fund and SAIF.

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses: annual and final. Annual bonuses are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits fund held a provision on the Pillar I Peak 2 basis of £24 million (2009: £31 million) at 31 December 2010 to honour guarantees on a small amount of guaranteed annuity option products.

Beyond the generic features and the provisions held in respect of guaranteed annuities described above, there are very few explicit options or guarantees of the with-profits fund such as minimum investment returns, surrender values, or annuity values at retirement and any granted have generally been at very low levels.

The Group's main exposure to guaranteed annuity options in the UK is through SAIF and a provision on the Pillar I Peak 2 basis of £336 million (2009: £284 million) was held in SAIF at 31 December 2010 to honour the guarantees. As SAIF is a separate sub-fund of the Prudential Assurance Company long-term fund which is attributable to policyholders of the fund, the movement in the provision has no direct impact on shareholders.

Time value

The value of financial options and guarantees comprises two parts. One is given by a deterministic valuation on best estimate assumptions (the intrinsic value). The other part arises from the variability of economic outcomes in the future (the time value).

Where appropriate, a full stochastic valuation has been undertaken to determine the value of the in-force business including the cost of capital. A deterministic valuation of the in-force business is also derived using consistent assumptions and the time value of the financial options and guarantees is derived as the difference between the two.

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations. Assumptions specific to the stochastic calculations reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of long-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with an allowance for correlation between the various asset classes. Details of the key characteristics of each model are given in note 16.

ii Level of required capital

In adopting the EEV Principles, Prudential has based required capital on its internal targets for economic capital subject to it being at least the local statutory minimum requirements. Economic capital is assessed using internal models but, when applying the EEV Principles, Prudential does not take credit for the significant diversification benefits that exist within the Group. For with-profits business written in a segregated life fund, as is the case in Asia and the UK, the capital available in the fund is sufficient to meet the required capital requirements. For shareholder-backed business the following capital requirements apply:

- Asian operations: the level of required capital has been set at the higher of local statutory requirements and the economic capital requirement;
- US operations: the level of required capital has been set to an amount at least equal to 235 per cent of the risk-based capital required by the National Association of Insurance Commissioners (NAIC) at the Company Action Level (CAL); and
- UK insurance operations: the capital requirements are set at the higher of Pillar I and Pillar II requirements for shareholder-backed business of UK insurance operations as a whole, which for 2010 and 2009 was Pillar I.

iii Allowance for risk and risk discount rates

Overview

Under the EEV Principles, discount rates used to determine the present value of future cash flows are set equal to risk-free rates plus a risk margin. The risk margin should reflect any non-diversifiable risk associated with the emergence of distributable earnings that is not allowed for elsewhere in the valuation. Prudential has selected a granular approach to better reflect differences in market risk inherent in each product group. The risk discount rate so derived does not reflect an overall Group market beta but instead reflects the expected volatility associated with the cash flows for each product category in the embedded value model.

Since financial options and guarantees are explicitly valued under the EEV methodology, discount rates under EEV are set excluding the effect of these product features.

The risk margin represents the aggregate of the allowance for market risk, additional allowance for credit risk where appropriate, and allowance for non-diversifiable non-market risk. No allowance is required for non-market risks where these are assumed to be fully diversifiable. The majority of non-market and non-credit risks are considered to be diversifiable.

Market risk allowance

The allowance for market risk represents the beta multiplied by an equity risk premium. Except for UK shareholder-backed annuity business (as explained below) such an approach has been used for all of the Group's businesses.

The beta of a portfolio or product measures its relative market risk. The risk discount rates reflect the market risk inherent in each product group and hence the volatility of product cash flows. These are determined by considering how the profits from each product are affected by changes in expected returns on various asset classes. By converting this into a relative rate of return it is possible to derive a product specific beta.

Product level betas are calculated each year. They are combined with the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

Additional credit risk allowance

The Group's methodology is to allow appropriately for credit risk. The allowance for credit risk is to cover:

- expected long-term defaults;
- credit risk premium (to reflect the volatility in default levels); and
- short-term downgrades and defaults.

These allowances are initially reflected in determining best-estimate returns and through the market risk allowance described above. However, for those businesses which are largely backed by holdings of debt securities these allowances in the projected returns and market risk allowances may not be sufficient and an additional allowance may be appropriate.

The practical application of the allowance for credit risk varies depending upon the type of business as described below.

Asian operations

For Asian operations, the allowance for credit risk incorporated in the projected rates of return and the market risk allowance are sufficient. Accordingly no additional allowance for credit risk is required.

US business

For Jackson business, the allowance for long-term defaults is reflected in the risk margin reserve charge which is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

The risk discount rate incorporates an additional allowance for credit risk premium and short-term defaults for general account business of 150 basis points and for variable annuity business of 30 basis points to reflect the fact that a proportion of the variable annuity business is allocated to the general account.

The level of allowance differs from that for UK annuity business for investment portfolio differences and to take account of the management actions available in adverse economic scenarios to reduce crediting rates to policyholders, subject to guarantee features of the products.

UK business

a Shareholder-backed annuity business

For Prudential's UK shareholder-backed annuity business, Prudential has used a market consistent embedded value (MCEV) approach to derive an implied risk discount rate which is then applied to the projected best estimate cash flows.

In the annuity MCEV calculations, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on Prudential's assessment of the expected return on the assets backing the annuity liabilities after allowing for expected long-term defaults, credit risk premium and short-term downgrades and defaults. For the purposes of presentation in the EEV results, the results on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for expected long-term defaults and, where necessary, an additional allowance for an element of short-term downgrades and defaults to bring the allowance in the earned rate up to best estimate levels. The allowances for credit risk premium and additional short-term default allowance are incorporated into the risk margin included in the discount rate.

b With-profit fund PAL annuity business

For UK annuity business written by PAL the basis for determining the aggregate allowance for credit risk is consistent with that applied for UK shareholder-backed annuity business and includes provision for short-term defaults and credit risk premium. The allowance for credit risk in PAL is taken into account in determining the projected cash flows to the with-profits fund, which are in turn discounted at the risk discount rate applicable to all of the projected cash flows of the fund.

c With-profit fund holdings of debt securities

The UK with-profits fund holds debt securities as part of its investment portfolio backing policyholder liabilities and unallocated surplus. The assumed earned rate for with-profit holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

Allowance for non-diversifiable non-market risks

Finance theory cannot be used to determine the appropriate component of beta for non-diversifiable non-market risks since there is no observable risk premium associated with it that is akin to the equity risk premium. Recognising this, a pragmatic approach has been applied.

A base level allowance of 50 basis points is applied to cover the non-diversifiable non-market risks associated with the Group's businesses. For the Group's US business and UK business for other than shareholder-backed annuity, no additional allowance is necessary. For UK shareholder-backed annuity business, an additional allowance of 50 basis points is used to reflect the longevity risk which is of particular relevance. For the Group's Asian operations in China, India, Indonesia, Philippines, Taiwan, Thailand and Vietnam, additional allowances are applied for emerging market risk ranging from 100 to 250 basis points.

iv Management actions

In deriving the time value of financial options and guarantees, management actions in response to emerging investment and fund solvency conditions have been modelled. Management actions encompass, but are not confined to investment allocation decisions, levels of reversionary and terminal bonuses and credited rates. Bonus rates are projected from current levels and varied in accordance with assumed management actions applying in the emerging investment and fund solvency conditions.

In all instances, the modelled actions are in accordance with approved local practice and therefore reflect the options actually available to management. For the PAC with-profits fund, the actions assumed are consistent with those set out in the Principles and Practices of Financial Management.

v With-profits business and the treatment of the estate

The proportion of surplus allocated to shareholders from the PAC with-profits fund has been based on the present level of 10 per cent. The value attributed to the shareholders' interest in the estate is derived by increasing final bonus rates (and related shareholder transfers) so as to exhaust the estate over the lifetime of the in-force with-profits business. In those few extreme scenarios where the total assets of the life fund are insufficient to meet policyholder claims in full, the excess cost is fully attributed to shareholders. Similar principles apply, where appropriate, for other with-profit funds of the Group's Asian operations.

vi Pension costs

The Group operates three defined benefit schemes in the UK. The principal scheme is the Prudential Staff Pension Scheme (PSPS). The other two, much smaller, schemes are the Scottish Amicable and M&G schemes.

Under IFRS the surpluses or deficits attaching to these schemes are accounted for in accordance with the provisions of IAS 19 that apply the principles of IFRIC 14, providing guidance on assessing the limit in IAS 19 on the amount of surplus in a defined benefit pension scheme that can be recognised as an asset.

Under the EEV basis the IAS 19 basis surpluses (to the extent not restricted under IFRIC 14) or deficits are initially allocated in the same manner. The shareholders' 10 per cent interest in the PAC with-profits fund estate is determined after inclusion of the portion of the IAS 19 basis surpluses or deficits attributable to the fund. Adjustments under EEV in respect of accounting for surpluses or deficits on the Scottish Amicable Pension Scheme are reflected as part of UK operations and for other defined benefit schemes the adjustments are reflected as part of 'Other operations', as shown in note 7.

Separately, the projected cash flows of in-force covered business include the cost of contributions to the defined benefit schemes for future service based on the contribution basis applying to the schemes at the time of the preparation of the results.

vii Debt capital

Core structural debt liabilities are carried at market value. As the liabilities are generally held to maturity or for the long-term, no deferred tax asset or liability has been established on the difference, compared to the IFRS carrying value. Accordingly, no deferred tax credit or charge is recorded in the results for the reporting period in respect of the mark to market value adjustment.

viii Foreign currency translation

Foreign currency profits and losses have been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year-end rates of exchange. The purpose of translating the profits and losses at average exchange rates, notwithstanding the fact that EEV profit represents the incremental value added on a discounted cash flow basis, is to maintain consistency with the methodology applied for IFRS basis reporting.

c Accounting presentation

i Analysis of profit before tax

To the extent applicable, presentation of the EEV profit for the year is consistent with the basis that the Group applies for analysis of IFRS basis profits before shareholder taxes between operating and non-operating results. Operating results reflect the underlying results including longer-term investment returns and, except as explained in note 1c(iv) below, the unwind of discount on the value of in-force business. Operating results include the impact of routine changes of estimates and non-economic assumptions.

Non-operating results comprise the recurrent items of short-term fluctuations in investment returns, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, the mark to market value movements on core borrowings and the effect of changes in economic assumptions.

In addition, for 2010, the Company incurred costs associated with the terminated AIA transaction and the Group's holding in PruHealth was diluted. The effect of both of these items has been shown separately from operating profits based on longer-term investment returns.

In 2009, during the severe equity market conditions experienced in the first quarter, coupled with historically high equity volatility, the Group incurred non-recurrent costs from an exceptional short-dated hedge to protect against potential tail events on the Group IGD capital position in addition to regular operational hedging programmes. These costs incurred in 2009 have been shown separately within short-term fluctuations in investment returns. Also, in June 2009, the Group completed the disposal of the Taiwan agency business. The effect of this disposal and the results of the Taiwan agency business have been presented separately outside of the operating result.

ii Operating profit

For the investment element of the assets covering the net worth of long-term insurance business, investment returns are recognised in operating results at the expected long-term rate of return. These expected returns are calculated by reference to the asset mix of the portfolio. For the purpose of calculating the longer-term investment return to be included in the operating result of the PAC with-profits fund of UK operations, where assets backing the liabilities and unallocated surplus are subject to market volatility, asset values at the beginning of the reporting period are adjusted to remove the effects of short-term market movements as explained in note 1c (iv) below.

For the purpose of determining the long-term returns for debt securities of US operations for fixed annuity and other general account business, a risk margin charge is included which reflects the expected long-term rate of default based on the credit quality of the portfolio. For Jackson, interest-related realised gains and losses are amortised to the operating results over the maturity period of the sold bonds and for equity-related investments, a long-term rate of return is assumed, which reflects the aggregation of year-end risk-free rates and equity risk premium. For US variable annuity separate account business, operating profit includes the unwind of discount on the opening value of in force adjusted to reflect year-end projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with the related hedging activity.

For UK annuity business, rebalancing of the asset portfolio backing the liabilities to policyholders may from time to time take place to align it more closely with the internal benchmark of credit quality that management applies. Such rebalancing will result in a change in the projected yield on the asset portfolio and the allowance for default risk. The net effect of these changes is reflected in the result for the year. In general, the effect is booked in operating results.

iii Effect of changes in operating assumptions

Operating profits include the effect of changes to operating assumptions on the value of in-force at the end of the period. For presentational purposes, the effect of change is delineated to show the effect on the opening value of in-force with the experience variance being determined by reference to the end of period assumptions.

iv Unwind of discount and other expected returns

The unwind of discount and other expected returns is determined by reference to the value of in-force business, required capital and surplus assets at the start of the period as adjusted for the effect of changes in economic and operating assumptions reflected in the current period.

For UK insurance operations the amount included within operating results based on longer-term investment returns represents the unwind of discount on the value of in-force business at the beginning of the period (adjusted for the effect of current period assumption changes), the unwind of discount on additional value representing the shareholders' share of smoothed surplus assets retained within the PAC with-profits fund (as explained in note 1b(v) above), and the expected return on shareholders' assets held in other UK long-term business operations. Surplus assets retained within the PAC with-profits fund are smoothed for this purpose to remove the effects of short-term investment volatility from operating results. In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed.

v Pension costs

Profit before tax

Movements on the shareholders' share of surpluses (to the extent not restricted by IFRIC 14) and deficits of the Group's defined benefit pension schemes adjusted for contributions paid in the year are recorded within the income statement. Consistent with the basis of distribution of bonuses and the treatment of the estate described in note 1b(iv) and (v), the shareholders' share incorporates 10 per cent of the proportion of the financial position attributable to the PAC with-profits fund. The financial position is determined by applying the requirements of IAS 19.

Actuarial and other gains and losses

For pension schemes in which the IAS 19 position reflects the difference between the assets and liabilities of the scheme, actuarial and other gains and losses comprise:

- the difference between actual and expected return on the scheme assets;
- experience gains and losses on scheme liabilities;
- the impact of altered economic and other assumptions on the discounted value of scheme liabilities; and
- for pension schemes where the IAS 19 position reflects a deficit funding obligation, actuarial and other gains and losses includes the movement in estimates of deficit funding requirements.

These items are recorded in the income statement but, consistent with the IFRS basis of presentation, are excluded from operating results based on longer-term investment returns.

vi Effect of changes in economic assumptions

Movements in the value of in-force business at the beginning of the period caused by changes in economic assumptions, net of the related change in the time value of cost of option and guarantees, are recorded in non-operating results.

vii Taxation

The profit for the year for covered business is in most cases calculated initially at the post-tax level. The post-tax profit for covered business is then grossed up for presentation purposes at the effective rates of tax applicable to the countries and periods concerned. In the UK the effective rate applied for 2010 is 27 per cent (2009: 28 per cent). For Jackson, the US federal tax rate of 35 per cent is applied to gross up movements on the value of in-force business. The overall tax rate includes the impact of tax effects determined on a local regulatory basis. For Asia, similar principles apply subject to the availability of taxable profits.

viii Inter-company arrangements

The EEV results for covered business incorporate the effect of the reinsurance arrangement of non-profit immediate pension annuity liabilities of SAIF (which is not covered business) to PRIL. In addition, the analysis of free surplus and value of in-force business takes account of the impact of contingent loan arrangements between Group companies.

ix Foreign exchange rates

Foreign currency results have been translated as discussed in note 1b(viii), for which the principal exchange rates are as follows:

Local currency: £	Average rate	Closing rate at	Average rate	Opening rate at

	Closing rate at 31 Dec 2010	for 2010	31 Dec 2009	for 2009	1 Jan 2009
China	10.32	10.46	11.02	10.70	9.86
Hong Kong	12.17	12.01	12.52	12.14	11.14
India	70.01	70.66	75.15	75.70	70.05
Indonesia	14,106.51	14,033.41	15,171.52	16,173.28	15,799.22
Korea	1,776.86	1,786.23	1,880.45	1,989.75	1,810.92
Malaysia	4.83	4.97	5.53	5.51	5.02
Singapore	2.01	2.11	2.27	2.27	2.07
Taiwan	45.65	48.65	51.65	51.65	47.28
US	1.57	1.55	1.61	1.57	1.44

x Discontinued operations

The charge of £(14) million in 2009, which is net of £nil tax, reflected completion adjustments for a previously disposed business.

2 Analysis of new business contributionnote iv

	Year ended 31 Dec 2010						
	New business premiums		Annual premium and contribution equivalents (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution	New business margin note i	
	Single	Regular	note i	note i	notes ii,iii	(APE)	(PVNBP)
	£m	£m	£m	£m	£m	%	%
Asian operationsnotes v, vi	1,104	1,391	1,501	7,493	902	60	12.0
US operationsnote vii	11,417	22	1,164	11,572	761	65	6.6
UK insurance operationsnote viii	5,656	254	820	6,842	365	45	5.3
Total	18,177	1,667	3,485	25,907	2,028	58	7.8

	Year ended 31 Dec 2009						
	New business premiums		Annual premium and contribution equivalents (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution	New business margin note i	
	Single	Regular	note i	note i	notes ii,iii	(APE)	(PVNBP)
	£m	£m	£m	£m	£m	%	%
Asian operationsnote v	785	1,131	1,209	5,982	725	60	12.1
US operationsnote vii	8,885	24	912	9,048	664	73	7.3
UK insurance operationsnote viii	4,768	246	723	5,902	230	32	3.9
Total	14,438	1,401	2,844	20,932	1,619	57	7.7

	New business margin (APE) %	
	2010	2009

Asian operations:note v			
	China	47	50
	Hong Kong	74	70
	India	20	19
	Indonesia	75	73
	Korea	31	44
	Taiwan	13	18
	Other	79	87
Weighted average for all Asian operations		60	60

Notes

i New business margins are shown on two bases, namely the margins by reference to Annual Premium Equivalents (APE) and the Present Value of New Business Premiums (PVNBP) and are calculated as the ratio of the value of new business profit to APE and PVNBP. APE are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. PVNBP are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution.

ii In determining the EEV basis value of new business written in the period the policies incept, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.

iii New business contributions represent profits determined by applying operating assumptions as at the end of the year. In general, the use of point of sale or end of period economic assumptions is not significant in determining the new business contribution for different types of business and across financial reporting periods. However, to obtain proper measurement of the new business contribution for business which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business was priced. In practice, the only area within the Group where this has a material effect is for UK shareholder-backed annuity business. For other business within the Group end of period economic assumptions are used.

iv The amounts shown in the tables are translated at average exchange rates for the period.

v The tables above include new business for the Taiwan bank distribution operation. New business excludes the Taiwan Agency business, which was sold in June 2009 (as explained in note 19) and the Japanese insurance operations, in which the Company ceased selling new business from 15 February 2010.

vi The new business contribution in 2010 of £902 million for Asian operations includes a benefit of around £5 million arising from the application of the 'active' basis of economic assumption setting rather than the previously applied basis of an assessment of longer-term economic conditions, as described in note 1b.

vii The decrease in new business margin for US operations from 2009 to 2010 primarily reflects the changes to the assumed new business spread margins for Fixed Annuity and Fixed Index Annuity business as described in note 16a.

viii The increase in new business margin for UK operations from 2009 to 2010 primarily reflects the signing of a bulk annuity buy-in insurance agreement.

3 Operating profit from business in force

Group Summary

	Year ended 31 Dec 2010			
	Asian operations note i	US operations note ii	UK operations note iii	Total
	£m	£m	£m	£m
Unwind of discount and other expected returns	573	369	550	1,492
Effect of change in operating assumptions	(23)	3	(3)	(23)
Experience variances and other items	(1)	325	24	348
Total	549	697	571	1,817

	Year ended 31 Dec 2009			
	Asian operations note i	US operations note ii	UK operations note iii	Total
	£m	£m	£m	£m
Unwind of discount and other expected returns	489	344	588	1,421
Effect of change in operating assumptions	(12)	101	-	89
Experience variances and other items	(85)	124	52	91
Total	392	569	640	1,601

Notes

Analysis by business unit

i Asian operations

	2010	2009
	£m	£m
Unwind of discount and other expected returnsa	573	489
Effect of change in operating assumptions:		
Mortality and morbidityb	89	26
Expensec	(62)	(32)
Persistencyd	(75)	(78)
Othere	25	72
	(23)	(12)
Experience variance and other items:		
Mortality and morbidityf	45	52
Expenseg	(39)	(43)
Persistencyh	(48)	(76)
Other i	41	(18)
	(1)	(85)
Total Asian operationsj	549	392

Notes

a The increase in unwind of discount and other expected returns from £489 million for 2009 to £573 million for 2010 mainly arises from the growth in the opening value of the in-force book.

b The credit of £89 million (2009: £26 million) for mortality and morbidity assumption changes mainly arises in Indonesia of £72 million comprising £36 million for relaxation of morbidity assumptions and £36 million to reflect recent experience in relation to protection benefits provided by unit-linked policies. The favourable effect of £26 million in 2009 primarily arises in Indonesia of £24 million reflecting recent experience.

c The charge of £(62) million in 2010 for expense assumption changes includes a charge in Korea of £(40) million, to reflect higher policy maintenance costs. Also included for 2010 is a charge of £(16) million in Malaysia relating to altered maintenance expense assumptions. The charge of £(32) million for strengthened expense assumptions in 2009 arises principally in Hong Kong of £(23) million with the balance arising across the regions.

d The charge of £(75) million in 2010 for the effect of changes in persistency assumptions mainly arises in Indonesia (£(33) million), Malaysia (£(26) million) and India (£(24) million) partly offset by a credit in Hong Kong (£16 million). The charge in Indonesia of £(33) million primarily relates to Shariah and single premium policies for which lower renewal rates have been experienced. The charge in Malaysia of £(26) million reflects altered premium holiday and other lapse assumptions and the charge in India of £(24) million represents changes in the paid-up assumption on linked business.
The negative effect of the change in persistency assumptions of £(78) million in 2009 are mainly a direct consequence of the impact on policyholders' savings behaviour from adverse economic and market conditions, arising mostly with investment related products, principally in Korea (£(25) million), Indonesia (£(24) million) and Hong Kong (£(12) million).

e The credit of £72 million for other assumption changes in 2009 comprises the one-off positive impact of £69 million for altered projected net of tax cash flows arising from a regulatory reclassification of health and protection products in Hong Kong, a credit of £13 million for the effect of altered application of the Group's EEV methodology and a net charge of £(10) million for other items. The £13 million effect comprises adjustments for asset management margins in Indonesia and Korea of £37 million and a charge of £(24) million to better align the assumed capital requirement with internal management and pricing bases, primarily in China, Indonesia, Philippines and Vietnam, and other minor adjustments with a neutral net effect.

f The favourable effect of £45 million in 2010 (2009: £52 million) for mortality and morbidity experience variances reflects better than expected experience, most significantly in Hong Kong, Singapore and Malaysia.

g The expense experience variance of £(39) million in 2010 (2009: £(43) million) includes a charge of £(18) million (2009: £(16) million) for expense overruns for operations which are at a relatively early stage of development, for which actual expenses are in excess of those factored into the product pricing. Also included in 2010 is £(9) million arising in Taiwan (2009: £(8) million) reflecting over-runs whilst the business rebuilds scale following the sale of the Agency business and in 2009, an expense variance of £(10) million arose in Korea, reflecting the lower level of sales in the period.

h The negative persistency experience variance of £(48) million in 2010 mainly arises in India of £(27) million relating to higher paid-ups and surrenders on unit-linked business and in Malaysia of £(26) million for higher partial withdrawals on unit-linked business as customers sought to monetise a proportion of their funds following two years of exceptional returns.

The charge of £(76) million in 2009 relating to negative persistency experience arises across the region with the largest impacts in Korea (£(29) million), India (£(11) million) and Japan (£(9) million).

i The credit of £41 million in 2010 for other experience and other items includes a credit of £24 million arising in Indonesia for the impact of additional riders being added to in-force policies during the year, funded from the policyholder unit linked account balances.

j The in-force operating profit for 2010 of £549 million reflects the effect of setting economic assumptions on an 'active' basis rather than the previously applied 'passive' basis as described in note 1(b), the impact of which was to lower in-force operating profits in 2010 by £58 million, principally for altered unwind of discount.

ii US operations

		2010	2009
		£m	£m
Unwind of discount and other expected returnsa		369	344
Effect of changes in operating assumptions:			
	Guaranteed Minimum Withdrawal Benefit (GMWB) policyholder behaviourb	-	156
	Mortalityc	10	33
	Variable Annuity (VA) feesd	27	(13)
	Othere	(34)	(75)
		3	101
Experience variances and other items:			
	Spread experience variancef	158	(3)
	Amortisation of interest-related realised gains and lossesg	82	59
	Expenseh	32	40
	Mortalityi	21	32
	Persistencyj	23	7
	Other	9	(11)
		325	124
Total US operations		697	569

Notes

a The increase in unwind of discount and other expected returns from £344 million for 2009 to £369 million for 2010 primarily represents an increase in the return on net worth arising from a higher opening value between 1 January 2009 and 1 January 2010.

b The positive impact of the change in GMWB policyholder behaviour assumptions of £156 million for 2009 reflects the altered assumptions relating to the utilisation of withdrawal features available to policyholders on Variable Annuity (VA) contracts which have been modified to take account of the more recent experience of policyholder behaviour when benefits are 'in the money'. Previously, policyholder behaviour for the utilisation of GMWB was assumed to be largely driven by the extent to which benefits were in the money. For 2009, the assumption was altered to take account of recent experience which shows that the attained age of the policyholder is the key factor in determining utilisation levels.

c The credit of £10 million for updates to mortality assumptions in 2010 represents a credit of £29 million for business other than variable annuity, reflecting recent experience, partially offset by a negative effect on variable annuity business of £(19) million for a change in the modelling of mortality rates. The £33 million credit for mortality in 2009 primarily reflects lower mortality rates for the Life of Georgia business, based upon actual experience since the acquisition of the business in 2005.

d The effect of the change of assumption for VA fees represents the capitalised value of the change in the projected level of policyholder advisory fees, which vary according to the size and mix of VA funds. The credit of £27 million for 2010 reflects an increase in the projected level of fees paid by policyholders, according to the current fund mix. The negative effect of the change in 2009 of £(13) million represents a reduction in the level of fees.

e The charge of £(34) million for other operating assumption changes in 2010 includes a credit of £4 million for the overall effect of changes to persistency assumptions and the net effect of a number of items including a charge of £(19) million for the altered projection of life reserves run-off. The effect of other changes in assumptions in 2009 of £(75) million primarily represents the negative impact of changes in persistency assumptions of £(53) million, reflecting an increase in the assumed utilisation of the partial withdrawal option on Variable and Fixed Annuity business of £(29) million and £(24) million for the effect of other altered lapse rates, in line with experience.

f The spread assumption for Jackson is determined on a longer-term basis, net of provision for defaults. The spread experience variance in 2010 is a positive £158 million, arising principally from transactions undertaken in the year to more closely match the overall asset and liability duration the effect of which is expected to persist in 2011 but at a reduced level.

g The amortisation of interest-related gains and losses reflects the same treatment applied to the supplementary analysis of IFRS profit. When bonds that are neither impaired nor deteriorating are sold and reinvested there will be a consequent change in the investment yield. The realised gain or loss is amortised into the result over the period when the bonds would have otherwise matured to better reflect the long-term returns included in operating profits. The increase in amortisation of interest-related gains and losses from £59 million in 2009 to £82 million in 2010 reflects the increased level of realised gains in the second half of 2009, on which a full year's amortisation is recognised in 2010.

h The positive expense experience variance of £32 million (2009: £40 million) primarily represents favourable experience variance relating to marketing expenses.

i The positive mortality experience variance of £21 million (2009: £32 million) primarily relates to life products.

j The positive persistency experience variance of £23 million primarily arises from favourable experience on annuity and institutional business.

iii UK insurance operations

	2010	2009
	£m	£m
Unwind of discount and other expected returnsa	550	588

Effect of changes in operating assumptions:			
	Updated mortality assumptions, net of release of marginsb	(40)	-
	Expensec	37	-
		(3)	-
Effect of change in UK corporate tax rated		41	-
Other itemse		(17)	52
Total UK insurance operations		571	640

Notes

a The decrease in unwind of discount and other expected returns from 2009 of £588 million to £550 million in 2010 mainly arises from the impact of the reduction in discount rates, reflecting the decrease in gilt rates of 0.4 per cent.

b The Continuous Mortality Investigation (CMI) model and Core Projection parameters have been reviewed and a custom parameterisation of the CMI model has been made where some aspects of the pattern of convergence from current rates of improvements to long-term rates of improvement have been altered. The assumption change shown above of a charge of £(40) million represents the effect of the implementation of the custom parameterisation on the opening value of in-force business at 1 January 2010, offset by the effects of other mortality assumption changes and the release of margins on the base mortality assumptions.

c The credit of £37 million in 2010 for changes in operating expense assumptions relates to renewal expense assumptions on shareholder backed annuity business.

d At 31 December 2010 a change to reduce the UK corporate tax rate from 28 per cent to 27 per cent with effect from 1 April 2011 had been enacted in the legislative process. The effect of the change in the corporate tax rate of £41 million represents the pre-tax benefit arising from the change in projecting the tax cash flows attaching to in-force business.

e The credit of £52 million in 2009 includes a credit of £22 million for the effects of rebalancing the UK annuity business asset portfolio backing the liabilities to policyholders, reflecting the altered value arising from the revised projected yield and allowances for default risk.

4 Short-term fluctuations in investment returns

Short-term fluctuations in investment returns, net of the related change in the time value of cost of options and guarantees, arise as follows:

		2010	2009
		£m	£m
Insurance operations:			
	Asianote i	287	437
	USnote ii	(678)	(401)
	UKnote iii	336	445
Other operations:			
	IGD hedge costsnote iv	-	(235)
	Othernote v	25	105
Total		(30)	351

Notes

i Asian operations	2010	2009
	£m	£m
Indonesia	55	40
Hong Kong	51	113
Taiwan	40	20
Malaysia	37	40
Singapore	16	159
Other operations	88	65
	287	437

For 2010 short-term fluctuations for Asian operations of £287 million primarily reflect the favourable performance in equity markets across the territories. The short-term fluctuations for other operations in 2010 of £88 million include an unrealised gain of £30 million on the Group's 8.66 per cent stake in China Life Insurance Company of Taiwan, which at 31 December 2010 was valued at £100 million. For 2009, the short-term fluctuations in investment returns in Asia of £437 million reflect the effect of strong equity market performance in particular for participating business and unit-linked business where the in-force value benefits from increases in shareholder transfers and from the capitalisation of increased projected fees due to the higher asset base at the end of the year.

ii US operations

The fluctuations for US operations comprise the following items:

	2010	2009
	£m	£m
Actual realised losses less default assumption and amortisation of interest-related gains and losses for fixed income securities and related swap transactionsa	(351)	(367)
Actual less long-term return on equity based investments and other itemsb	5	(144)
Investment return related (loss) gain due primarily to changed expectation of profits on in-force variable annuity business in future periods based on current period equity returns, net of related hedging activity for equity related productsc	(332)	110
	(678)	(401)

Notes

a The charges relating to fixed income securities for 2010 of £(351) million and 2009 of £(367) million shown above primarily represent the excess of credit-related losses in the year on the US statutory basis over the amortisation of interest-related gains and longer-term default assumption included within operating profit, together with for 2010, the impact of de-risking activities within the portfolio.

b The charge in 2009 of £(144) million for actual less long-term return on equity based investments and other items primarily relates to the shortfall of actual return against the expected return on investments in limited partnerships.

c This item arises due to the market returns, net of related hedging activity, being higher or lower than the assumed longer-term rate of return. This gives rise to higher or lower than expected period end values of variable annuity assets under management with a resulting effect on the projected value of future account values and hence future profitability from altered fees. For 2010 the US equity market returns were 14.5 per cent compared to the assumed longer-term rate of 6.8 per cent for the period which was more than offset by the impact of hedging activity. For 2009 the US equity market returns were approximately 24 per cent compared to the assumed longer-term rate of 7.4 per cent for the period.

iii UK insurance operations

The short-term fluctuations in investment returns for UK insurance operations represents:

	2010	2009
	£m	£m
With-profitsa	218	430
Shareholder-backed annuityb	84	(40)
Unit-linked and otherc	34	55
	336	445

Notes

a For with-profits business the credit for 2010 of £218 million reflects the positive 12.0 per cent actual investment return on the investments of the PAC with-profits fund (covering policyholder liabilities and unallocated surplus) against the assumed long-term rate of 6.7 per cent. The credit of £430 million for 2009 reflects the positive variance of 8.6 per cent against the assumed long-term investment return.

b Short-term fluctuations in investment returns for shareholder-backed annuity business include gains (losses) on surplus assets relative to the expected return due to a fall (rise) in yields, the difference between actual and expected default experience and mismatching profits and losses arising from the impacts of changes in yields on assets and liabilities of differing durations. The short-term fluctuations in investment returns for 2010 of a credit of £84 million represent better than expected default experience of £64 million, higher than expected gains arising on surplus assets of £55 million, partially offset by mismatching losses of £(21) million, and other impacts of £(14) million. The charge of £(40) million for 2009 represents mismatching losses of £(105) million, partially offset by better than expected default experience of £22 million with the remaining balance of £43 million consisting of positive movements in other asset values partially offset by losses on surplus assets.

c The credit of £34 million for 2010 (2009: credit of £55 million) primarily relates to unit-linked business representing the increase in capitalised value of future fees arising from the positive movements in market values experienced during the relevant reporting periods.

iv IGD hedge costs

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

v Other operations

Short-term fluctuations in investment returns of other operations, in addition to the previously discussed IGD hedge costs for 2009, arise from:

	2010	2009
	£m	£m
Unrealised value movements on swaps held centrally to manage Group assets and liabilities	(25)	28
Unrealised value movements on Prudential Capital bond portfolio	48	66
Unrealised value movements on investments held by other operations	2	11
	25	105

5 Effect of changes in economic assumptions

The effects of changes in economic assumptions for in-force business, net of the related change in the time value of cost of options and guarantees, included within the profit from continuing operations before tax (including actual investment returns) arise as follows:

	2010	2009
	£m	£m
Asian operationsnote i	(71)	(174)
US operationsnote ii	(1)	(518)
UK insurance operationsnote iii	62	(218)
Total	(10)	(910)

Notes

i The charge of £(71) million in Asian operations for the effect of changes in economic assumptions in 2010 primarily represents the effect of derisking certain asset portfolios in Hong Kong and Singapore of £(73) million, together with the impact of the reduction in fund earned rates and risk discount rates as shown in note 16(a), including the effect of altering the basis of setting economic assumptions to the 'active' basis as described in note 1(b). The charge for 2009 of £(174) million primarily reflects increases in risk discount rates and fund earned rates, with the largest impact arising for Hong Kong US dollar denominated business arising from the increase in US dollar government bond yields, partly offset by a credit of £96 million for the effect of altered economic assumptions for Indonesia and Korea arising from a change in the application of the Group's methodology for these operations (as discussed in note 16a).

ii The charge of £(1) million for the effect of changes in economic assumptions, net of the related change in the time value of cost of options and guarantees, for US operations for 2010 reflects the following:

	2010	2009
	£m	£m
Effect of changes in treasury rates, beta and equity risk premium:a		
Fixed annuity and other general account business	111	(398)
Variable Annuity (VA) business	(112)	181
Increase in risk margin allowance for credit riskb	-	(301)
	(1)	(518)

Notes

a For Jackson, the charge for the effect of changes in economic assumptions represents the aggregate of the effects of changes to projected returns and the risk discount rate. The risk discount rate, as discussed in note 1b(iii), represents the aggregate of the risk-free rate and margin for market risk, credit risk and non-diversifiable non-market risk.

For fixed annuity and other general account business the effect of changes to the risk-free rate, which is defined as the 10-year treasury rate, is reflected in the risk discount rate. This discount rate is in turn applied to projected cash flows which principally reflect projected spread, which is largely insensitive to changes in the risk-free rate. Secondary effects on the cash flows also result from changes to assumed future yield and resulting policyholder behaviour. For VA business, changes to the risk-free rate are also reflected in determining the risk discount rate. However, the projected cash flows are also reassessed for altered investment returns on the underlying separate account assets from which fees are charged. For 2010, the effect of these changes resulted in an overall credit for fixed annuity and other general account business of £111 million and a charge of £(112) million for VA business reflecting the reduction of 0.6 per cent in the risk-free rate (as shown in note 16a).

For 2009, the effect of these changes resulted in an overall charge for fixed annuity and other general account business of £(398) million and an overall credit on VA business of £181 million, reflecting the increase in the risk-free rate of 1.6 per cent.

b For 2010 and 2009, the Group has included an additional allowance for credit risk. In determining this allowance a number of factors were considered. These factors, in particular, include:

i How much of the credit spread on debt securities represents an increased credit risk not reflected in the Risk Margin Reserve (RMR) long-term default assumptions, and how much is liquidity premium. In assessing this effect consideration has been given to a number of approaches to estimating the liquidity premium by considering statistical data over the four years from 2006 to 2009, and

ii Policyholder benefits for Jackson fixed annuity business are not fixed. It is possible in adverse economic scenarios to pass on a component of credit loss to policyholders (subject to guarantee features) through lower crediting rates. Consequently, it is only necessary to allow for the balance of the credit risk in the risk discount rate.

After taking these and other more detailed factors into account and, based on market conditions in late 2009, the risk discount rate for general account business was increased by 150 basis points as an additional allowance for credit risk. For VA business, the additional allowance increase was set at 20 per cent of the non-VA business increase to reflect the fact that a proportion of the VA business is allocated to general account holdings of debt securities. For 2010 these additional allowances have been maintained at 2009 levels. The additional allowance to be applied in future reporting periods will be altered, as necessary, for future credit conditions and as the business in force alters over time.

iii The effect of changes in economic assumptions, net of the related change in the time value of cost of options and guarantees, of a credit of £62 million for UK insurance operations for 2010 comprises the effect of:

	2010 £m			2009 £m		
	Shareholder-backed annuity business note a	With-profits and other business note b	Total	Shareholder-backed annuity business note a	With-profits and other business note b	Total
(Decrease) increase in expected long-term rates of return	(102)	(80)	(182)	(284)	191	(93)
Decrease (increase) in risk discount rates	55	183	238	240	(311)	(71)
Other changes	(6)	12	6	25	(79)	(54)
	(53)	115	62	(19)	(199)	(218)

Notes

a For 2010, the effects of decreases in expected long-term rates of return and risk discount rates for shareholder-backed annuity business primarily reflect the reduction in gilt rates of 0.4 per cent, as shown in note 16a. In 2009, the overall charge of £(19) million reflects the effects of regular economic assumption changes. However, the amounts for the component line items shown above reflect a change in the composition of the default allowance between best estimate levels (which are reflected in the long-term rates of return) and allowance for credit risk premium and additional short-term defaults reflected in the risk discount rate.

b

For 2010, the credit of £115 million for with-profits and other business reflects a decrease in risk discount rates which more than offsets the reduction in fund earned rates, primarily driven by the decrease in gilt rates of 0.4 per cent in the year. In 2009, the charge of £(199) million for with-profits and other business reflects the fact that the risk discount rate has increased significantly more than the earned rate as a result of the revised correlation assumptions, lower equity backing ratio and very low cash return.

6 Costs of terminated AIA transaction

The following costs were incurred in relation to the proposed and subsequently terminated transaction, to purchase AIA Group Limited and related rights issue.

	2010
	£m
AIG termination break fee	153
Underwriting fees	58
Costs associated with foreign exchange hedging	100
Adviser fees and other	66
Total costs before tax	377
Associated tax relief	(93)
Total costs after tax	284

7 Shareholders' funds (excluding non-controlling interests) - segmental analysis

	Note	2010 £m	2009 £m
Asian operations			
Long-term business:			
Net assets of operations - EEV basis shareholders' fundsnote iv		7,445	5,781
Acquired goodwillnote iii		236	80
		7,681	5,861
Asset management:note i			
Net assets of operations		197	161
Acquired goodwill		61	61
		258	222
		7,939	6,083
US operations			
Jackson - EEV basis shareholders' funds (net of surplus note borrowings of £172 million (2009: £158 million) note 9)		4,799	4,122
Broker-dealer and asset management operationsnote i			
Net assets of operations		106	95
Acquired goodwill		16	16
		122	111
		4,921	4,233
UK operations			
Insurance operations:			
Long-term business operations:			
Smoothed shareholders' funds		5,911	5,547
Actual shareholders' funds less smoothed shareholders' funds		59	(108)
EEV basis shareholders' funds		5,970	5,439
Othernote i		33	37
		6,003	5,476

M&G:note i			
Net assets of operations		254	173
Acquired goodwill		1,153	1,153
		1,407	1,326
		7,410	6,802
Other operations			
Holding company net borrowings at market value	9	(2,212)	(1,780)
Other net assets (liabilities)note i		149	(65)
		(2,063)	(1,845)
Total		18,207	15,273

Representing:	2010 £m			2009 £m		
	Statutory IFRS basis shareholders' equity	Additional retained profit on an EEV basis	EEV basis shareholders' equity	Statutory IFRS basis shareholders' equity	Additional retained profit on an EEV basis	EEV basis shareholders' equity
Asian operations	2,149	5,532	7,681	1,462	4,399	5,861
US operations	3,815	984	4,799	3,011	1,111	4,122
UK insurance operations	2,115	3,855	5,970	1,902	3,537	5,439
Total long-term business operations	8,079	10,371	18,450	6,375	9,047	15,422
Other operationsnote ii	(48)	(195)	(243)	(104)	(45)	(149)
Group total	8,031	10,176	18,207	6,271	9,002	15,273