PRUDENTIAL PLC
Form 6-K
August 08, 2018

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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**

August 8, 2018

Commission File Number: 1-15040

PRUDENTIAL PUBLIC LIMITED COMPANY

(Name of Registrant)

**12 Arthur Street,
London EC4R 9AQ, 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 is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ___

Indicate by check mark whether the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ___

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This report on Form 6-K is hereby incorporated by reference, in its entirety, into Prudential Public Limited Company's registration statements on Form F-3 (File No. 333-219863) and Form S-8 (File No. 333-213731).

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

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FORWARD-LOOKING STATEMENTS

This Prudential Half Year Financial Report may contain 'forward-looking statements' with respect to certain of Prudential's plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations and including, without limitation, statements containing the words 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', 'intends', 'expects', 'plans', 'seeks' and 'anticipates', and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore undue reliance should not be placed on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, the timing, costs and successful implementation of the demerger of the M&G Prudential business; the future trading value of the shares of Prudential plc and the trading value and liquidity of the shares of the to-be-listed M&G Prudential business following such demerger; future market conditions, including fluctuations in interest rates and exchange rates, the potential for a sustained low-interest rate environment, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives; the political, legal and economic effects of the UK's decision to leave the European Union; the impact of continuing designation as a Global Systemically Important Insurer or 'G-SII'; the impact of competition, economic uncertainty, inflation and deflation; the effect on Prudential's business and results from, in particular, mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of internal projects and other strategic actions failing to meet their objectives; disruption to the availability, confidentiality or integrity of Prudential's IT systems (or those of its suppliers); the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal and regulatory actions, investigations and disputes. These and other important factors may, for example, result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. Further discussion of these and other important factors that could cause Prudential's actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential's forward-looking statements can be found under the 'Risk Factors' heading of this Half Year Financial Report, as well as under the 'Risk Factors' heading of any subsequent Prudential Annual Report furnished to the US Securities and Exchange Commission on Form 20-F.

Any forward-looking statements contained in this Half Year Financial Report speak only as of the date on which they are made. Prudential expressly disclaims any obligation to update any of the forward-looking statements contained in this report or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, the Hong Kong Listing Rules, the SGX-ST listing rules or other applicable laws and regulations. Prudential may also make or disclose written and/or oral forward-looking statements in reports filed with or furnished to the US Securities and Exchange Commission, the Prudential Regulation Authority (the 'PRA') and Financial Conduct Authority or other regulatory authorities, as well as in its annual report and accounts to shareholders, periodic financial reports to shareholders, proxy statements, offering circulars, registration statements, prospectuses and, prospectus supplements, press releases and other written materials and in oral statements made by directors, officers or employees of Prudential to third parties, including financial analysts. All such forward-looking statements are qualified in their entirety by reference to the factors discussed under the 'Risk Factors' heading of this Half Year Financial Report, as well as under the 'Risk Factors' heading of any subsequent filing Prudential makes with the US Securities and Exchange Commission, including any subsequent Annual Report on Form 20-F. These factors are not exhaustive as Prudential operates in a continually changing business environment with new risks emerging from time to time that it may be unable to predict or that it currently does not expect to have a material adverse effect on its business.

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SUMMARY OF OUR BUSINESS

About Prudential plc

Prudential is an international financial services group serving over 26 million customers and with £664 billion of assets under management (as at 30 June 2018). Prudential plc is incorporated in England and Wales and its ordinary shares are listed on the stock exchanges in London, Hong Kong and Singapore, and its American Depository Receipts ('ADRs') are listed on the New York Stock Exchange.

Prudential plc is the parent company of the Prudential group (the 'Prudential Group', 'Prudential' or the 'Group'). Prudential is not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America.

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Selected Historical Financial Information

The following table sets forth selected consolidated financial data for Prudential for the periods indicated. Certain data is derived from Prudential's consolidated financial statements prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 30 June 2018, there were no unendorsed standards effective for the periods presented below which impact the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, the selected consolidated financial data presented below that is derived from Prudential's consolidated financial statements has been prepared in accordance with IFRS as issued by the IASB. This table is only a summary and should be read in conjunction with Prudential's unaudited condensed consolidated interim financial statements and the related notes included elsewhere in this document, together with the Financial Review section.

	Six months ended 30 June		
	2018(1) (In $ millions)	**2018 (In £ millions)**	**2017 (In £ millions)**
Income statement data			
Gross premiums earned	**28,164**	**21,341**	22,105
Outward reinsurance premiums	**(17,105)**	**(12,961)**	(947)
Earned premiums, net of reinsurance	**11,059**	**8,380**	21,158
Investment return	**1,892**	**1,434**	20,629
Other income(8)	**1,458**	**1,105**	1,137
Total revenue, net of reinsurance	**14,409**	**10,919**	42,924
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(5,948)**	**(4,507)**	(35,442)
Acquisition costs and other expenditure (8)	**(5,985)**	**(4,535)**	(5,245)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(249)**	**(189)**	(216)
(Loss) gain on disposal of businesses and corporate transactions	**(75)**	**(57)**	61
Re-measurement of the sold Korea life business	**-**	**-**	5
Total charges, net of reinsurance and (loss) gain on disposal of businesses	**(12,257)**	**(9,288)**	(40,837)
Share of profits from joint ventures and associates, net of related tax	**135**	**102**	120
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*(2)	**2,287**	**1,733**	2,207
Tax charges attributable to policyholders' returns	**(44)**	**(33)**	(393)
Profit before tax attributable to shareholders	**2,243**	**1,700**	1,814
Tax charge attributable to shareholders' returns	**(454)**	**(344)**	(309)
Profit for the period	**1,789**	**1,356**	1,505

	Six months ended 30 June		
	2018(1)	**2018**	**2017**
Other data			
Based on profit for the period attributable to the equity holders of the Company:			
Basic earnings per share	**69.5 ¢**	**52.7p**	58.7p
Diluted earnings per share	**69.4 ¢**	**52.6p**	58.6p
Dividend per share paid in reporting period:			
Second interim dividend for prior year(5)	**42.89 ¢**	**32.50p**	30.57p
Equivalent cents per share(6)		**43.80¢**	39.80¢
Market price per share at end of period(7)	**2,290¢**	**1,735p**	1,761p
Weighted average number of shares (in millions)		**2,573**	2,565

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	As at 30 June		As at 31 December
	2018(1) (In $ millions)	**2018 (In £ millions)**	**2017 (In £ millions)**
Statement of financial position data			
Total assets	**661,394**	**501,170**	493,941
Total policyholder liabilities and unallocated surplus of with-profits funds	**557,923**	**422,765**	428,194
Core structural borrowings of shareholder-financed operations	**8,403**	**6,367**	6,280
Total liabilities	**640,424**	**485,280**	477,847
Total equity	**20,970**	**15,890**	16,094

	As of and for the six months ended 30 June		
	2018(1) (In $ millions)	**2018 (In £ millions)**	**2017 (In £ millions)**
Other data			
New business:			
Single premium sales(3)	**21,081**	**15,974**	16,984
New regular premium sales(3)(4)	**2,276**	**1,725**	1,926
Funds under management	**876,809**	**664,400**	638,100

(1)

Amounts stated in US dollars in the half year 2018 US dollar column have been translated from pounds sterling at the rate of $1.3197 per £1.00 (the noon buying rate in New York City on 29 June 2018).

(2)

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

(3)

The new business premiums in the table shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders (see 'EEV basis, new business results and free surplus generation' below). The amounts shown are not, and are not intended to be, reflective of premium income recorded in the IFRS income statement. Internal vesting business is classified as new business where the contracts include an open market option.

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

(4)

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

(5)

Under IFRS, dividends declared or approved after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event. The appropriation reflected in the statement of changes in equity, therefore, includes dividend in respect of the prior year that was declared or approved after the balance sheet date of the prior reporting period. The parent company dividends relating to the reporting period were a first interim ordinary dividend of 15.67p per share, as against a first interim dividend of 14.50p per share for the first half of 2017.

(6)

The dividend per share has been translated into US dollars at the noon buying rate in New York City on the date each payment was made.

(7)

Market prices presented are the closing prices of the shares on the London Stock Exchange on the last day of trading for each indicated period.

(8)

The half year 2017 comparative results have been re-presented from those previously published for deduction of certain expenses against revenue following the adoption of IFRS 15. See note A2 to the unaudited condensed consolidated interim financial statements for further details.

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Summary Overview of Operating and Financial Review and Prospects

The following summary discussion and analysis should be read in conjunction with Prudential's unaudited condensed consolidated interim financial statements and the related notes for the period ended 30 June 2018 included in this document.

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

The results discussed below are not necessarily indicative of the results to be expected in the full year 2018 or in any future periods. This discussion contains forward-looking statements based on current expectations, which involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in these forward-looking statements due to a number of factors, including those set forth in 'Risk Factors' and elsewhere in this document.

Introduction and Overview

In the first half of 2018, Prudential continued to provide a broad range of financial products and services, primarily to the retail market. Prudential's principal operations continue to be in Asia, the United States and the United Kingdom and Europe. The accounting policies applied by Prudential in determining the IFRS basis results reflected in Prudential's unaudited condensed consolidated interim financial statements for the period ended 30 June 2018 are the same as those previously adopted in Prudential's consolidated financial statements for the year ended 31 December 2017, except for the adoption of the new accounting pronouncements as described in note A2 to the unaudited condensed consolidated interim financial statements.

We have had a good first half of 2018, delivering high-quality, profitable growth. This performance has been achieved alongside good progress towards the demerger of M&G Prudential from Prudential plc, announced in March, which will create two separately listed businesses with distinct investment prospects and capital allocation priorities.

Each of our businesses is built around strong and growing customer needs. The savings and protection requirements of the Asian middle class, the retirement income needs of Americans and the increasing demand for managed savings solutions in the UK and Europe are creating sustained opportunities. We continue to target profitable growth in high-quality, recurring-premium health and protection and fee business.

Currency volatility

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

Since 2014 we have adopted the approach of evaluating the financial performance of the Group by presenting percentage growth rates before the impact of the fluctuations in the value of sterling against local currencies in the US and Asia. In a period of currency volatility this approach allows a more meaningful assessment of underlying performance trends. This is because our businesses in the US and Asia receive premiums and pay claims in local currencies and are, therefore, not exposed to any cross-currency trading effects. To maintain comparability in the discussion below the same basis has been applied. Growth rates based on actual exchange rates are also shown in the financial tables presented in this report. Consistent with previous reporting periods, the assets and liabilities of our overseas businesses are translated at period-end exchange rates so the effect of currency movements has been fully incorporated within reported shareholders' equity.

The table below explains how the Group's profit after tax on an IFRS basis reconciles to profit before tax and the supplementary analysis of operating profit based on longer-term investment returns. Further explanation on the determination of operating profit based on longer-term investment returns is provided in the 'Basis of Performance Measures' section. Further explanation on non-operating items is provided in the sub-section 'Non-operating items'. The table presents the half year 2017 results on both an actual exchange rate and constant exchange rate basis so as to eliminate the impact of exchange translation. Actual Exchange Rates ('AER') are actual historical exchange rates for the specific accounting period, being the average rates over the period for the income statement and the closing rates for the balance sheet at the balance sheet date. Constant

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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.

IFRS Profit

	Actual Exchange Rate			Constant Exchange Rate	
	2018 £m Half year	**2017* £m Half year**	**Change %**	**2017* £m Half year**	**Change %**
Profit after tax for the period attributable to shareholders	**1,356**	1,505	(10)%	1,425	(5)%
Tax charge attributable to shareholders' returns	**344**	309	11%	295	17%
Profit before tax attributable to shareholders	**1,700**	1,814	(6)%	1,720	(1)%
Non-operating items:					
Losses from short-term fluctuations in investment returns	**113**	573	(80)%	523	(78)%
Amortisation of acquisition accounting adjustments	**22**	32	(31)%	29	(24)%
Loss (gain) on disposal of businesses and corporate transactions	**570**	(61)	n/a	(61)	n/a
	705	544	30%	491	44%
Operating profit before tax based on longer-term investment returns	**2,405**	2,358	2%	2,211	9%
Analysed into:					
Asia	**1,016**	953	7%	891	14%
US	**1,002**	1,073	(7)%	982	2%
UK and Europe	**778**	745	4%	745	4%
Other income and expenditure	**(329)**	(382)	14%	(376)	13%
Restructuring costs	**(62)**	(31)	(100)%	(31)	(100)%
Operating profit before tax based on longer-term investment returns	**2,405**	2,358	2%	2,211	9%

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

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

Financial performance

Our financial performance is again led by Asia, which delivered double-digit growth in operating profit based on longer-term investment returns[1].

Profit after tax for half year 2018 was £1,356 million compared to a profit of £1,505 million in the first half of 2017 (on an actual exchange rate basis). The decrease reflects the movement in profit before tax attributable to shareholders, which decreased from £1,814 million in half year 2017 (on an actual exchange rate basis) to £1,700 million in half year 2018 and an increase in the tax charge attributable to shareholders' returns from £309 million in half year 2017 (on an actual exchange rate basis) to £344 million in half year 2018.

On an actual exchange rate basis, the decrease in profit before tax attributable to shareholders from £1,814 million in half year 2017 to £1,700 million in half year 2018 reflects the unfavourable change in non-operating items of £161 million, from a loss of £544 million to a loss of £705 million, partially offset by an increase in operating profit based on longer-term investment returns of £47 million. The unfavourable change in non-operating items of £161 million is primarily attributable to the pre-tax loss of £513 million arising on the reinsurance of a portion of UK annuities to Rothesay Life effective in March 2018, partially offset by a

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favourable change in short-term fluctuations in investment returns of £460 million (from a loss of £573 million to a loss of £113 million) following a rise in interest rates in the US. The improvement of £47 million in total operating profit based on longer-term investment returns on an actual exchange rate basis primarily reflects an increase in Asia (from £953 million to £1,016 million), the UK and Europe (from £745 million to £778 million) and a favourable movement in loss from other income and expenditure (from a loss of £382 million to £329 million), partially offset by a decrease in the US operating profit (from £1,073 million to £1,002 million). The increase of £47 million or 2 per cent in total operating profit based on longer-term investments includes a negative exchange translation impact of £147 million. Excluding the currency volatility, on a constant exchange rate basis, total operating profit based on longer-term investment returns increased from £2,211 million to £2,405 million, 9 per cent higher than the equivalent amount in half year 2017.

Operating profit from our Asia life insurance business increased by 14 per cent[2] and profit from Eastspring, our Asia asset management business, by 13 per cent[2], in line with the uplift in average assets under management. In the US, total operating profit was up 2 per cent[2], with growth in fee income driven by higher average separate account balances, offset by an expected reduction in spread earnings and a higher DAC amortisation charge. In the UK and Europe, M&G Prudential's total operating profit increased by 4 per cent, driven by 10 per cent growth in operating profit from asset management operations.

The Group's capital generation continues to be underpinned by our large and growing in-force portfolio and our focus on profitable, short-payback business. Overall net cash remitted to the corporate centre in the first half of 2018 was £1,111 million (2017: £1,230 million on an actual exchange rate basis), with Asia being the largest contributor of net remittances to the Group at £391 million (2017: £350 million).

The Group remains strongly capitalised, with a Solvency II cover ratio of 209 per cent[3,4]. Over the period, IFRS shareholders' funds reduced to £15.9 billion, reflecting profit after tax of £1.4 billion (including, as anticipated, a pre-tax loss of £513 million on the reinsurance of £12 billion[5] of annuity liabilities), the 2017 second interim dividend and negative revaluation movements.

External asset management net flows[6] were £2.7 billion, driven by M&G Prudential asset management.

In Asia, we continue to focus on growing our scale and enhancing the quality of our returns. While headline sales for the half year declined, our businesses saw improved performance in the second quarter compared to the same period in 2017. This quarterly growth was broad based with six businesses (including Hong Kong and China) growing at a double digit rate.

In the US, while variable annuity sales were slightly reduced and institutional sales were 19 per cent[2] lower, the combination of higher interest rates and beneficial tax reform underpinned an increase in profits.

M&G Prudential continues to perform well, with robust external net inflows of £3.5 billion in its external asset management business and PruFund-related net inflows of £4.4 billion. Overall assets under management[7] were £341.9 billion, £9 billion lower than at the end of 2017, mainly as a result of the £12 billion[5] of annuity liabilities reinsured to Rothesay Life, announced in March.

Long-term opportunities

We are focused on long-term, sustainable opportunities arising from structural trends in Asia, the US, the UK and Europe.

Across Asia, the multiple insurance markets in which we operate are benefiting from economic and demographic tailwinds that are driving demand for our products. Our prospects are underpinned by low insurance market penetration (currently under 3 per cent[8]), high levels of out-of-pocket healthcare spend (42 per cent of total spend[9]), a fast-rising working population (1 million per month, expected to rise to 2.5 billion people by 2030[10]) and improved life expectancy (the number of people over 60 years of age is expected to double to over 1 billion by 2050[10]). The scale of our presence across life and asset management, which gives us access to 3.6 billion people[11], means that our business is well placed to benefit from these trends.

In the United States, the world's largest retirement market, approximately 40 million people will reach retirement age over the next decade alone[12]. These consumers have a clear need for investment options that will increase their savings and protect their incomes for the rest of their lives. We are broadening the range of options we offer in order to meet the varied preferences of these consumers and intermediaries.

In the UK and Europe, the number of people of retirement age is forecast to grow by 55 million over the next four decades[13]. The region's wealth is increasingly concentrated in the hands of the older generations: in the UK the over-55s control two-thirds of the nation's total wealth[14]. Many of these savers want products that offer better returns than cash, while smoothing out the ups and downs of markets. M&G Prudential is ideally placed to meet this growing demand for investment solutions with its market-leading with-profits fund and comprehensive range of actively managed funds. Once demerged from the Group, supported by the benefits of its merger and transformation programme, M&G Prudential is expected to be in an even better position to serve these customers as an independent, capital-efficient business.

Developing our businesses

We are constantly working to improve what we do for our customers, across all our markets. We pay close attention to their changing needs and respond with an evolving suite of high-quality products and services. At the same time, we constantly develop our capabilities to serve our customers and add value for our shareholders.

In Asia, we are continuing to build our broad-based portfolio of businesses and improve the way we serve our customers. We employ a multi-channel strategy to maximise our reach across the region. Our highly productive agency force is complemented by our bancassurance partnerships, which have expanded following the signing of new agreements in Thailand, the Philippines, Indonesia and Vietnam so far this year. We maintain a contemporary suite of products and remain at the forefront of product developments, evolving our offering to meet changing customer needs. In Hong Kong, we launched a new critical illness product with extended protection for cancer, heart attacks and strokes, three common causes of death. In Singapore we unveiled PRUVital cover, a first-in-the-market protection plan, for customers with four types of pre-existing chronic medical conditions, and in China we have recently started offering customers a new savings product, designed with education costs in mind. To support our agency and bank channels, we also embrace new digital capabilities to increase efficiency and improve our customers' experience. In Hong Kong, for example, we developed two new innovations, 'Hospital to Prudential' and 'Chatbot Claims', to redefine the way our customers and medical professionals manage hospital claims, significantly reducing the time and effort required. In addition we have recently announced an exclusive partnership with UK-based Babylon Health[15] that will add a comprehensive set of digital health tools to our existing world-class protection products. Through a Babylon-enabled digital platform we will offer customers in up to 12 Asian markets a world-leading suite of Artificial Intelligence ('AI') health services, including personal health assessment and treatment information, empowering users to proactively manage their health in a flexible and cost-efficient manner.

China represents an important growth opportunity for us. Operating through our joint venture, CITIC-Prudential, we now have access to around 70 per cent of the population following the disciplined expansion of our footprint over the past 18 years. In April we took another step forward when CITIC-Prudential received regulatory approval to begin preparations for the establishment of a new branch in Hunan, China's seventh-largest province, with a population of 68 million. Our business in China is the highest rated in the industry for risk management[16], and was among the first group of insurers to be granted approval to offer a tax-deferred pension insurance programme, as part of a pilot programme targeted on Shanghai, Suzhou and Fujian.

Eastspring, our Asian fund manager is well placed to capitalise on the expected growth in Asia's retail mutual fund market. Eastspring has a presence in 11 markets across the region following its recent entry into Thailand in July. Eastspring's consistent investment performance helped it to win Asian Investor's prestigious Asia Fund House of the Year award for 2018, for the third time in four years. In China, the establishment of our investment management wholly foreign-owned enterprise will enable Eastspring to create an on-the-ground team that will operate an onshore investment management business. This business complements our existing asset management joint venture partnership with CITIC and represents an important step in deepening our presence in this market.

In the US, we continue to develop our business to ensure that we best address the opportunity presented by the millions of Americans entering retirement and their need for secure income. During the first half of 2018, we

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continued to strengthen our position in the US fee-based advisory market through new relationships with key distributors and the launch of relevant products, including a new fee-based index annuity. Jackson has also played a leading role in bringing together 24 of the country's financial services organisations to launch the Alliance for Lifetime Income. This aims to educate Americans about the need for protected retirement income, enabling more customers to take action to secure their financial futures.

In the UK and Europe, M&G Prudential continues to improve customer outcomes, leveraging our scale, financial strength and complementary product and distribution capabilities to develop and deliver capital-efficient investment solutions for a range of customer needs. It is one year since we announced the merger and transformation of M&G and Prudential UK & Europe. In that time, we have made good progress, announcing a new partnership with Tata Consulting Services to modernise our existing life portfolio, developing a combined approach to distribution and creating central service functions. M&G Prudential's investment products continue to perform well. We announced £2.1 billion in annual with-profits bonuses, lifting the value of contracts by up to 10 per cent and marking the ninth consecutive year of positive returns for investors in our market-leading PruFund. Over the three years to 30 June, 58 per cent of M&G's retail funds generated returns in the upper quartiles of performance. We would like to thank Anne Richards for her contribution to the Group's success as Chief Executive of M&G Investments. As announced on 27 July 2018, Anne is resigning from the Group, effective on 10 August 2018, to take up a new senior position in the financial services industry, and we wish her all the best.

We are also continuing to develop our newer but growing businesses in five markets in Africa. During the first half of the year sales rose, reflecting growth in our agency force and new distribution agreements with Standard Chartered Bank in Ghana and Zenith Bank in Nigeria and Ghana.

Demerger of M&G Prudential

At the same time as delivering growth in operating performance, we have been focused on progressing the actions needed for the demerger of M&G Prudential from the Group. Our internal teams have been mobilised and we are engaging positively with external stakeholders. We have also announced leadership changes at M&G Prudential in preparation for the demerger. Clare Bousfield will become Chief Financial Officer and John Foley, Chief Executive of M&G Prudential, will take on the additional responsibilities of becoming Chief Executive of the key regulated entities of M&G and Prudential UK & Europe. These changes will simplify the way we make decisions, improve accountability and align management capabilities with M&G Prudential's future needs as an independent listed business. As we outlined in March, we believe we will be better able to focus on meeting our customers' rapidly evolving needs and to deliver long-term value to investors as two separate businesses. Following separation, M&G Prudential will have control over its business strategy and capital allocation, which will enable it to play a greater role in developing the savings and retirement markets in the UK and Europe through two of the financial sector's most trusted brands, M&G and Prudential UK & Europe. Prudential plc, focused on our market-leading businesses in Asia and the US, will be strongly positioned to develop consistent, attractive returns and realise the growth potential across our international footprint.

Until the demerger is completed, the Bank of England's Prudential Regulation Authority (PRA) will continue to be the group-wide supervisor of Prudential plc. In line with the current Solvency II requirements, the PRA will be the group-wide supervisor of M&G Prudential following the demerger. After the demerger, Prudential plc's individual insurance and asset management businesses will continue to be supervised at a local entity level and local statutory capital requirements will continue to apply.The Supervisory College, made up of the authorities overseeing the principal regulated activities in jurisdictions where the future Prudential plc will operate, has made a collective decision that Hong Kong's Insurance Authority should become the new group-wide supervisor for Prudential plc and they have begun preparations to take over that role. Prudential plc will continue to be headquartered and domiciled in the United Kingdom and will continue to hold a premium listing on the London Stock Exchange. Both Prudential plc and M&G Prudential are expected to meet the criteria for inclusion in the FTSE 100 index.

Positive outlook

We remain focused on our purpose, which is to help remove uncertainty from the big events in the lives of our customers. We have strong underlying opportunities, a proven ability to deliver for our customers, an ongoing focus on risk management and a strong balance sheet. Our planned demerger of M&G Prudential demonstrates our commitment to creating shareholder value. We are confident that we are well positioned to continue to grow profitably and provide value for our shareholders and customers into the future.

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Notes

1. IFRS operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the unaudited condensed consolidated interim financial statements.
2. Increase stated on a constant exchange rate basis.
3. Before allowing for first interim dividend (31 December 2017: second interim dividend).
4. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
5. Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.
6. Net inflows exclude Asia Money Market Fund (MMF) inflows of £665 million (2017: net inflows £449 million on an actual exchange rate basis).
7. Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
8. Swiss Re Sigma 2017. Insurance penetration calculated as premiums in % of GDP. Asia penetration calculated on a weighted population basis.
9. World Health Organisation Global Health Observatory data repository (2013). Out of pocket as % of Total Health Expenditure. Asia calculated as a weighted average out of pocket.
10. United Nations, Department of Economic and Social Affairs, Population Division, World Population Prospects 2017 Revision.
11. United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision, custom data acquired via website.
12. Based on approximately 4 million people per year reaching age 65 over the period 2018 - 2028 Source: U.S. Census Bureau, Population Division.
13. Office for National Statistics & Eurostat.
14. Office for National Statistics.
15. Exclusivity is in respect of up to 12 health, life and pension markets in Asia.
16. Source: 2017 Solvency Aligned Risk Margin Requirements and Assessment (SARMRA) issued by the China Insurance Regulatory Commission (CIRC).

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FINANCIAL REVIEW

IFRS Critical Accounting Policies

Prudential's discussion and analysis of its financial condition and results of operations are based upon Prudential's consolidated financial statements, which have been prepared in accordance with IFRS as issued by the IASB and as endorsed by the EU. The Group's policy for preparing this condensed consolidated interim financial information is to use the accounting policies adopted by the Group in its last consolidated financial statements, as updated by any changes in accounting policies it intends to make in its next consolidated financial statements as a result of new or amended IFRS and other policy improvements. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 30 June 2018, there were no unendorsed standards effective for the period ended 30 June 2018 affecting the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the period ended 30 June 2018 has been prepared in accordance with IFRS as issued by the IASB. Prudential adopts mandatory requirements of new or altered EU-adopted IFRS standards when required, and may consider earlier adoption where permitted and appropriate in the circumstances.

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

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially give rise to different results under different assumptions and conditions.

Prudential's critical accounting policies and the critical aspects of its estimates and judgements in determining the measurement of the Group's assets and liabilities are further discussed 'IFRS Critical Accounting Policies' of the Group's 2017 annual report on Form 20-F. In preparing the unaudited condensed consolidated interim financial statements included elsewhere in this document, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were for the same items as those described therein, which are:

- Classification of insurance and investment contracts;
- Measurement of policyholder liabilities and unallocated surplus of with-profits;
- Deferred acquisition costs for insurance contracts;
- Financial investments Valuation;
- Financial investments Determining impairment in relation to financial assets; and
- Intangible assets Carrying value of distribution rights.

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Summary Consolidated Results and Basis of Preparation Analysis

The following table shows Prudential's consolidated total profit on an actual exchange rate basis for the periods indicated.

	2018 £m Half year	2017 £m Half year
Total revenue, net of reinsurance*	**10,919**	42,924
Total charges, net of reinsurance and gain (loss) on disposal of businesses*	**(9,288)**	(40,837)
Share of profits from joint ventures and associates, net of related tax	**102**	120
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)***	**1,733**	2,207
Less tax charge attributable to policyholders' returns	**(33)**	(393)
Profit before tax attributable to shareholders	**1,700**	1,814
Total tax charge	**(377)**	(702)
Less: tax attributable to policyholders' returns	**33**	393
Tax charge attributable to shareholders' returns	**(344)**	(309)
Profit for the period	**1,356**	1,505

* The half year 2017 comparative results have been re-presented following the adoption of IFRS 15 as described in note A2 to the unaudited condensed consolidated interim financial statements.

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

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

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

Explanation of Movements in Profits After Tax and Profits Before Shareholder Tax by Reference to the Basis Applied for Segmental Disclosure

a) Group overview

Profit after tax for half year 2018 was £1,356 million compared to a profit of £1,505 million in the first half of 2017. The decrease reflects the movement in profit before tax attributable to shareholders, which decreased from £1,814 million in half year 2017 to £1,700 million in half year 2018 and an increase in the tax charge attributable to shareholders' returns from £309 million to £344 million.

The decrease in the total profit before shareholder tax from £1,814 million in half year 2017 to £1,700 million in half year 2018 is primarily due to an increase in non-operating losses of £161 million from negative £544 million to negative £705 million, slightly offset by an increase in operating profit based on longer-term investment returns of £47 million. The unfavourable change in non-operating items of £161 million is primarily due to an increase in losses on the disposal of businesses and corporate transactions from a gain of £61 million in half year 2017 to a loss of £570 million in half year 2018, partly offset by an improvement in short-term fluctuations of £460 million following a rise in interest rates in the US and a decrease in the amortisation of acquisition accounting adjustments of £10 million. Losses on the disposal of businesses and corporate transactions includes a pre-tax loss of £513 million arising from the reinsurance of a portfolio of UK and Europe annuity contracts with Rothesay Life.

The increase of £47 million or 2 per cent in operating profit based on longer-term investment returns includes a negative impact of exchange translation of £147 million. Excluding the currency volatility, on a constant exchange rate basis, the Group operating profit based on longer-term investment returns increased by £194 million or 9 per cent reflecting double digit growth in the Group's Asia business driven by the compounding nature of our regular premium protection businesses and also increases in the Group's US and UK and Europe businesses.

The half year 2018 effective rate of tax on the total profit attributable to shareholders was 20 per cent (half year 2017: 17 per cent). The increase was the result of total profit from US operations, which had a higher effective tax rate than the rates for the Group's other operations, forming a greater proportion of Group profit in the first half of 2018 (70 per cent) than in the first half of 2017 (16 per cent).

b) Summary by business segment and geographical region

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

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

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

The Group reassessed its segments in the second half of 2017 following the combination of the Group's UK insurance business and M&G to form M&G Prudential. Comparative segmental information for half year 2017 has been re-presented on a basis consistent with the current period.

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

	2018 £m	**2017* £m**
	Half year	**Half year**
Asia	**539**	907
US	**970**	245
UK and Europe	**117**	638
Total profit attributable to the segment	**1,626**	1,790
Unallocated to a segment**	**(270)**	(285)
Total profit for the year	**1,356**	1,505

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

**

Includes central operations (Group and Asia Regional Head Offices and Group borrowings), Prudential Capital and Africa operations.

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Asia

The following table shows the movement in profit arising from Asia operations and its components (insurance and asset management) for the periods indicated:

	2018 £m	2017 £m
	Half year	Half year
Insurance operations	**589**	968
Asset management	**89**	83
Profit before shareholder tax	**678**	1,051
Shareholder tax charge	**(139)**	(144)
Profit after tax	**539**	907

The decrease of £368 million in profit after tax from £907 million in half year 2017 to £539 million in half year 2018 primarily reflects a decrease in the profit before shareholder tax of £373 million from £1,051 million to £678 million marginally offset by a decrease in shareholder tax charge by £5 million to £139 million in half year 2018 from £144 million in half year 2017.

The decrease of £373 million in profit before shareholder tax includes a decrease of £379 million in insurance operations from £968 million in half year 2017 to £589 million in half year 2018 marginally offset by an increase of £6 million in asset management operations from £83 million to £89 million.

The decrease of £379 million in the profit before shareholder tax of insurance operations primarily reflects an unfavourable movement in non-operating items of £436 million from a gain of £98 million in half year 2017 to a loss of £338 million in half year 2018. This is partially offset by an increase in operating profit based on longer-term investment return of £57 million from £870 million to £927 million. The unfavourable change of £436 million in non-operating items was primarily due to a negative change of £367 million in short-term fluctuations in investment returns from, a gain of £41 million to a loss of £326 million, following rising interest rates in many markets in Asia leading to unrealised bond losses in the first half of 2018. Non-operating items for half year 2017 included a one-off cumulative exchange gain of £61 million recycled from other comprehensive income on the sold Korea life business. The increase of £57 million in operating profit based on longer-term investments includes a negative exchange translation impact of £58 million. Excluding the currency volatility, operating profit based on longer-term investment returns was up 14 per cent or £115 million on a constant exchange basis driven by continued growth in insurance margin, reflecting our focus on recurring premium health and protection business.

The increase of £6 million in the profit before shareholder tax of asset management operations from £83 million in half year 2017 to £89 million in half year 2018 includes an unfavourable exchange translation impact of £4 million. Excluding the currency volatility, profit from Asia asset management operations was up 13 per cent or £10 million on a constant exchange rate basis, in line with the uplift in Eastspring's average assets under management.

The effective shareholder tax rate on profits from Asia operations increased to 21 per cent in half year 2018 compared with 14 per cent in half year 2017, with the movement principally due to unrealised investment losses that are not tax deductible.

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United States

The following table shows the movement in profits arising from US operations and its components (insurance and asset management) for the periods indicated:

	2018 £m	**2017 £m**
	Half year	**Half year**
Insurance operations	**1,225**	297
Asset management	**(39)**	(6)
Profit before shareholder tax	**1,186**	291
Shareholder tax charge	**(216)**	(46)
Profit after tax	**970**	245

The increase of £725 million in profit after tax from £245 million in half year 2017 to £970 million in half year 2018 primarily reflects an increase in profit before shareholder tax from £291 million to £1,186 million, partly offset by an increase the shareholder tax charge from £46 million to £216 million.

The increase of £895 million in profit before shareholder tax includes an increase of £928 million in insurance operations from £297 million to £1,225 million partially offset by an increase of £33 million in asset management operations losses from negative £6 million to negative £39 million.

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

The £928 million increase in the profit before shareholder tax of the insurance operations in half year 2018 compared with half year 2017, is primarily due to a favourable movement in non-operating items of £1,006 million from a negative £782 million to a positive £224 million. This was partially offset by a decrease of £78 million in operating profit based on longer-term investment returns from £1,079 million to £1,001 million. The positive short-term fluctuations in the first half of 2018 reflects a 46 basis points rise in the 10 year US Treasury yield which has resulted in a favourable impact from the revaluation of the IFRS guarantee liabilities that Jackson provides on its annuity products.

The decrease of £78 million in operating profit based on longer-term investment returns includes a negative translation impact of £91 million. Excluding the currency volatility, operating profit based on longer-term investment return increased by £13 million or 1 per cent in half year 2018 on a constant exchange rate basis compared with half year 2017 reflecting increased fee income driven by a 10 per cent increase in separate account balances since 30 June 2017 offset by a decline in spread income, reflecting the impact of lower yields on our fixed annuity portfolio and reduced contribution from asset duration swaps, and a higher DAC amortisation charge. The higher DAC expense arises largely from a £42 million acceleration of amortisation relating primarily to the reversal of the benefit received in 2015 under the mean reversion formula, which is further discussed in note C5(b) of the unaudited condensed consolidated interim financial statements.

The £33 million increase in the loss before shareholder tax of the asset management in half year 2018 compared with half year 2017 is primarily due to additional costs incurred during the period in exiting from the NPH broker-dealer business which was disposed of in August 2017.

The effective shareholder tax rate on profits from US operations was 18 per cent in half year 2018 compared with 16 per cent in half year 2017.

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UK and Europe

The following table shows the movement in profits arising from UK and Europe operations and its components (insurance and asset management) for the periods indicated:

	2018 £m	**2017* £m**
	Half year	**Half year**
Insurance operations	**(123)**	506
Asset management	**266**	281
Profit before shareholder tax	**143**	787
Shareholder tax charge	**(26)**	(149)
Profit after tax	**117**	638

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

The decrease of £521 million in the profit after tax from £638 million in half year 2017 to £117 million in half year 2018 primarily reflects a decrease in the profit before shareholder tax of £644 million from £787 million to £143 million, partly offset by a decrease of £123 million in the shareholder tax charge from £149 million to £26 million.

The decrease of £644 million in profit before shareholder tax includes a decrease of £629 million in insurance operations from a profit of £506 million to a loss of £123 million and a decrease of £15 million in asset management operations profit from £281 million to £266 million.

The UK and Europe's results comprise an annual profit distribution to shareholders from its UK long-term with-profits fund as well as profits from its annuity and other businesses. For the UK and Europe insurance operations, a significant component of the annual contribution to shareholders' profit comes from its with-profits products. With-profits products are designed to provide policyholders with smoothed investment returns through a mix of regular and final bonuses.

For with-profits business (including non-participating business owned by The Prudential Assurance Company Limited with-profits fund), adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on the annual declaration of bonuses, shareholder profit for with-profits business is unaffected. This is because IFRS basis profits for the with-profits business, which are determined on the same basis as on grandfathered UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year.

The results of UK and Europe shareholder-backed annuity business reflect the inclusion of investment return including realised and unrealised gains and losses. The charge for benefits reflects the valuation rate of interest applied to discount future anticipated payments to policyholders. This rate in turn reflects current market yields adjusted for factors including default risks on the assets backing the liabilities. The level of allowance for default risk is a key assumption. Details are included in note B3 to the unaudited condensed consolidated interim financial statements.

The decrease in the profit before shareholder tax of the insurance operations of £629 million to a £123 million loss in half year 2018 was primarily driven by an adverse change in non-operating items of £638 million from a gain of £9 million in half year 2017 to a loss of £629 million in half year 2018. This adverse change of £638 million includes a pre-tax loss of £513 million arising from the reinsurance of a portfolio of UK and Europe annuity contracts with Rothesay Life, further details of which are provided in note D1 of the unaudited condensed consolidated interim financial statements. In addition, the adverse change includes a £125 million unfavourable movement in short-term fluctuations in investment returns from unrealised losses on fixed income assets supporting the capital of the shareholder-backed annuity business due to a rise in interest rates in the UK. Operating profits based on longer-term investments increased by £9 million from £497 million in half year 2017 to £506 million in half year 2018, reflecting increases in the UK with-profits transfer partially offset by the anticipated reduction in profit from in-force annuities following the reinsurance of £12 billion of annuity liabilities to Rothesay Life in March 2018. Operating earnings in the first half of 2018 also benefited from management

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actions of £63 million (half year 2017: £188 million) and a £166 million insurance recovery related to the costs of reviewing internally vesting annuities sold without advice after 1 July 2008, for which a provision of £400 million had previously been established.

The movement in profit before shareholder tax of the asset management operation reflects an increase in operating profit based on longer-term investment returns of £24 million or 10 per cent, which was from higher fees driven by higher average assets under management, more than offset by an adverse movement of £39 million in short-term fluctuations in investment returns.

The effective shareholder tax rate on profits from UK and Europe operations of 18 per cent in half year 2018 was broadly in line with the effective shareholder tax rate of 19 per cent in half year 2017.

Unallocated to a segment

The following table shows the movement in the unallocated to a segment result for the periods indicated:

	2018 £m	**2017* £m**
	Half year	**Half year**
Loss before shareholder tax	**(307)**	(315)
Shareholder tax credit	**37**	30
Loss after tax	**(270)**	(285)

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Total net charges for activity unallocated to a segment decreased by £15 million from £285 million in half year 2017 to £270 million in half year 2018 as higher restructuring costs relating to the UK merger and transformation programme were balanced by a reduction in the interest payable on core borrowings.

The effective tax rate on losses unallocated to a segment increased from 10 per cent at half year 2017 to 12 per cent at half year 2018, reflecting a reduction in the adverse impact of irrecoverable withholding tax on remittances from the Group's operation.

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Basis of Performance Measures

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

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

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

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

The Group reassessed its segments in the second half of 2017 following the combination of the Group's UK insurance business and M&G to form M&G Prudential. Comparative segmental information for half year 2017 has been re-presented on a basis consistent with the current period.

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 longer-term investment returns from other constituents of the total profit as follows:

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

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

(a) General principles

(i) UK style with-profits business

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

(ii) Unit-linked business

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

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(iii)

US variable annuity and fixed index annuity business

This business has guarantee liabilities which are measured on a combination of fair value and other, US GAAP derived, principles. These liabilities are subject to an extensive derivative programme to manage equity and interest rate exposures. 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, movements in liabilities for some types of business do require bifurcation to ensure that at the net level (ie after allocated investment return and charge for policyholder benefits) the operating result reflects longer-term market returns.

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

(v)

Other shareholder-financed business

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

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

Debt securities and loans

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

- Risk margin reserve based charge for the expected level of defaults for the period, which is determined by reference to the credit quality of the portfolio. The difference between impairment losses in the reporting period and the risk margin reserve charge to the 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 30 June 2018, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £818 million (half year 2017: net gain of £876 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 separate accounts are principally relevant for the US and Asia insurance operations. Different rates apply to different categories of equity-type securities.

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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 derivatives whose value movements are excluded from operating profit arises in Jackson, as discussed below in section (c).

(b)

Asia insurance operations

(i)

Business where policyholder liabilities are sensitive to market conditions

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

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

(ii)

Other Asia shareholder-financed business

Debt securities

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

Equity-type securities

For Asia insurance operations, investments in equity securities held for non-linked shareholder-backed operations amounted to £1,622 million as at 30 June 2018 (30 June 2017: £1,535 million). The rates of return applied for half year 2018 ranged from 5.1 per cent to 17.2 per cent (half year 2017: 4.7 per cent to 17.2 per cent) with the rates applied varying by business unit. These rates are broadly stable from period to period but may be different between countries reflecting, for example, differing expectations of inflation in each business unit. The assumptions are for the returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

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

(c)

US insurance operations

(i)

Separate account business

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

(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 (i) to the unaudited condensed consolidated interim financial statements:

Fair value movements for equity-based derivatives;

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

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

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

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

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Embedded derivatives for the 'not for life' portion of GMWB and fixed index annuity business

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

Embedded derivatives for variable annuity guarantee minimum income benefit

The GMIB liability, which is substantially 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. This accounting basis substantially does not recognise the effects of market movements. As the corresponding reinsurance asset is net settled, it is considered to be a derivative fair valued consistent with IAS 39, 'Financial Instruments: Recognition and Measurement'. As the GMIB is economically reinsured the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

(iii) Other derivative value movements

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

(iv) Other US shareholder-financed business

Debt securities

Jackson is the shareholder-backed operation for which the distinction between impairment losses and interest-related realised gains and losses is in practice relevant to a significant extent. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) developed by external third parties such as BlackRock Solutions to determine the average annual risk margin reserve to apply to debt securities held to back general account business. Debt securities held to back separate account and reinsurance funds withheld are not subject to risk margin reserve charge. Further details of the risk margin reserve charge, as well as the amortisation of interest-related realised gains and losses, for Jackson are shown in note B1.2 to the unaudited condensed consolidated interim financial statements.

Equity-type securities

As at 30 June 2018, the equity-type securities for US insurance non-separate account operations amounted to £1,187 million (half year 2017: £1,256 million). For these operations, the longer-term rates of return for income and capital applied in half year 2018 and 2017, which reflect the combination of the average risk-free rates over the period and appropriate risk premiums, are as follows:

	2018	**2017**
	Half year	**Half year**
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	**6.7% to 7.0%**	6.2% to 6.5%
Other equity-type securities such as investments in limited partnerships and private equity funds	**8.7% to 9.0%**	8.2% to 8.5%

The amounts of the actual less longer-term returns for the equity-type securities of the US insurance operations for half year 2018 and 2017 are shown in note B1.2(i) to the unaudited condensed consolidated interim financial statements.

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(d)

UK and Europe insurance operations

(i)

Shareholder-backed annuity business

For this business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the '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 shareholder-backed annuity business within The Prudential Assurance Company Limited (PAC) after adjustments to allocate the following elements of the movement to the category of 'short-term fluctuations in investment returns':

- The impact on credit risk provisioning of actual upgrades and downgrades during the period;
- Credit experience compared with assumptions; and
- Short-term value movements on assets backing the capital of the business.

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Positive or negative experience compared with assumptions is included within short-term fluctuations in investment returns without further adjustment. The effects of other changes to credit risk provisioning are included in the 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 and Europe insurance operations (other than the annuity business) the realised gains and losses are principally interest related. Accordingly, all realised gains and losses to date for these operations are being amortised over the period to the date those securities would otherwise have matured, with no explicit risk margin reserve charge.

(e)

Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply. For these businesses, it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include realised gains and losses in the operating result with temporary unrealised gains and losses being included in short-term fluctuations. In some instances, it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying economic substance of the arrangements.

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Analysis of operating profit based on longer-term investment returns

The following tables reconcile Prudential's operating profit based on longer-term investment returns to total profit attributable to shareholders.

	Half year 2018 £m					
	Asia	**US**	**UK and Europe**	**Total segment**	**Unallocated to a segment (other operations)**	**Group total**
Operating profit (loss) based on longer-term investment returns	**1,016**	**1,002**	**778**	**2,796**	**(391)**	**2,405**
Short-term fluctuations in investment returns on shareholder-backed business	**(326)**	**244**	**(122)**	**(204)**	**91**	**(113)**
Other non-operating items+	**(12)**	**(60)**	**(513)**	**(585)**	**(7)**	**(592)**
Profit (loss) before tax	**678**	**1,186**	**143**	**2,007**	**(307)**	**1,700**
Tax attributable to shareholders						**(344)**
Profit for the period						**1,356**

	Half year 2017 £m (AER)*					
	Asia	**US**	**UK and Europe**	**Total segment**	**Unallocated to a segment (other operations)**	**Group total**
Operating profit (loss) based on longer-term investment returns	953	1,073	745	2,771	(413)	2,358
Short-term fluctuations in investment returns on shareholder-backed business	41	(754)	42	(671)	98	(573)
Other non-operating items+	57	(28)	-	29	-	29
Profit (loss) before tax	1,051	291	787	2,129	(315)	1,814
Tax attributable to shareholders						(309)
Profit for the period						1,505

Half year 2017 £m (CER)*,**

	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Operating profit (loss) based on longer-term investment returns	891	982	745	2,618	(407)	2,211
Short-term fluctuations in investment returns on shareholder-backed business	28	(691)	42	(621)	98	(523)
Other non-operating items+	57	(25)	-	32	-	32
Profit (loss) before tax	976	266	787	2,029	(309)	1,720
Tax attributable to shareholders						(295)
Profit for the period						1,425

\+ Other non-operating items include primarily losses on the disposal of businesses and other corporate transactions. In half year 2018, these items include a pre-tax loss of £513 million arising from the reinsurance of a portfolio of UK and Europe annuity contracts with Rothesay Life.

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

** For half year 2017, the CER results were calculated using the half year 2018 average exchange rates.

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Explanation of Performance and Other Financial Measures

IFRS Profit

	Actual Exchange Rate			Constant Exchange Rate	
	2018 £m	**2017+ £m**	**Change %**	**2017*,+ £m**	**Change %**
	Half year	**Half year**		**Half year**	
Asia					
Insurance operationsnote (ii)	**927**	870	7%	812	14%
Asset management	**89**	83	7%	79	13%
Total Asia	**1,016**	953	7%	891	14%
US					
Jackson (US insurance operations) note (ii)	**1,001**	1,079	(7)%	988	1%
Asset management	**1**	(6)	117%	(6)	117%
Total US	**1,002**	1,073	(7)%	982	2%
UK and Europe					
UK and Europe insurance operations:					
Long-term businessnote (ii)	**487**	480	1%	480	1%
General insurance commission	**19**	17	12%	17	12%
Total UK and Europe insurance operations	**506**	497	2%	497	2%
UK and Europe asset management	**272**	248	10%	248	10%
Total UK and Europe	**778**	745	4%	745	4%
Total segment profit	**2,796**	2,771	1%	2,618	7%
Other income and expenditure7	**(329)**	(382)	14%	(376)	13%
Total operating profit based on longer-term investment returns before tax and restructuring costs	**2,467**	2,389	3%	2,242	10%
Restructuring costs7	**(62)**	(31)	(100)%	(31)	(100)%
Operating profit based on longer-term investment returns before taxnote (i)	**2,405**	2,358	2%	2,211	9%
Non-operating items:					
	(113)	(573)	80%	(523)	78%

Short-term fluctuations in investment returns on shareholder-backed business note (iii)					
Amortisation of acquisition accounting adjustments	**(22)**	(32)	31%	(29)	24%
(Loss) gain on disposal of businesses and corporate transactions	**(570)**	61	n/a	61	n/a
Profit before tax attributable to shareholders	**1,700**	1,814	(6)%	1,720	(1)%
Tax charge attributable to shareholders' returns	**(344)**	(309)	(11)%	(295)	(17)%
Profit for the period attributable to shareholders	**1,356**	1,505	(10)%	1,425	(5)%

*

For half year 2017, the CER results were calculated using the half year 2018 average exchange rate.

+

The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Notes

(i)

The Group provides supplementary analysis of IFRS profit before tax attributable to shareholders so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. Operating profit based on longer-term investment returns is the basis on which management regularly reviews the performance of Prudential's segments as defined by IFRS 8. Further discussion on the determination of operating profit based on longer-term investment returns is provided in B1.3 to the unaudited condensed consolidated interim financial statements and section 'Basis of Performance Measures' above.

(ii)

The results of the Group's long-term business operations are affected by changes to assumptions, estimates and bases of preparation. Where applicable, these are described in note B3 to the unaudited condensed consolidated interim financial statements.

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(iii)

Short-term fluctuations in investment returns on shareholder-backed business comprise:

	Actual Exchange Rate	
	2018 £m	**2017 £m**
	Half year	**Half year***
Asia	**(326)**	41
US	**244**	(754)
UK and Europe	**(122)**	42
Other operations	**91**	98
Total	**(113)**	(573)

*

The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Further details on the short-term fluctuations in investment returns are provided below and in note B1.2 to the unaudited condensed consolidated interim financial statements.

Earnings per share (EPS)

	Actual Exchange Rate			Constant Exchange Rate	
	2018 pence	**2017 pence**	**Change %**	**2017 pence**	**Change %**
	Half year	**Half year**		**Half year**	
Basic earnings per share based on operating profit after tax	**76.8**	70.0	10	65.7	17
Basic earnings per share based on total profit after tax	**52.7**	58.7	(10)	55.6	(5)

Our financial results in the first half of 2018 continue to reflect the benefits of driving targeted growth in high-quality, recurring premium health and protection and fee business across our geographies, products and distribution channels. We have also made progress in the on-going preparations for the demerger of M&G Prudential from Prudential plc and in delivering M&G Prudential's merger and transformation programme.

The growth in our financial performance across a wide range of metrics has again been led by our businesses in Asia which delivered double-digit growth in operating profit based on longer-term investment returns (up 14 per cent[1]). In the US, fee income[2] increased by 13 per cent[1] supported by higher average separate account balances and continued positive net flows, but was balanced by an expected reduction in spread income and increased amortisation of deferred acquisition costs.

M&G Prudential delivered external net inflows of £3.5 billion in its asset management business. This, together with PruFund related net inflows of £4.4 billion and the reduction arising from the previously announced reinsurance of a £12 billion[3] UK annuity portfolio, resulted in overall assets under management[4] of £341.9 billion at 30 June 2018 (31 December 2017: £350.7 billion). M&G Prudential remains on track to deliver the announced annual shareholder cost savings of circa £145 million by 2022 for a shareholder investment of circa £250 million.

Sterling weakened moderately compared with most of the currencies in our major international markets over the first half of 2018. However, average exchange rates over the first half of 2018 remained above those in the same period of 2017, leading to a negative effect on the translation of the results from our non-sterling operations. To aid comparison of underlying progress, we continue to express and comment on the performance trends of our international businesses on a constant currency basis.

During the first half of 2018 the performance of many equity markets was subdued and characterised by higher levels of volatility with the S&P 500 index up 2 per cent, the FTSE 100 index down 1 per cent and the MSCI Asia excluding Japan down 5 per cent. However, all these equity markets remain above first half 2017 levels. Longer term yields increased favourably in the US and in our larger Asia markets, but were only slightly higher in the UK.

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Consistent with the explanations made in the currency volatility section in the 'Summary overview of Operating and Financial Review and Prospects' comparison of the half year 2018 and half year 2017 performance is partially affected by the movements in average exchange rates used to translate into sterling the results of our overseas operations. Therefore, to facilitate explanations of changes in underlying performance, in the commentary on half year 2018 compared with half year 2017 discussions below, every time we comment on the performance of our businesses, we focus on their performance measured on the constant exchange rates basis unless otherwise stated. In each such case, the performance of our businesses in actual exchange rate terms was explained by the same factors discussed in the comments below and the impact of currency movements implicit in the constant exchange rate data.

The key operational highlights in the first half of 2018 were as follows:

Asset management net inflows at M&G Prudential were robust with external net inflows of £3.5 billion (2017: net inflows of £7.2 billion) in its wholesale/direct and institutional business. Eastspring reported external net outflows of £0.9 billion excluding money market funds (2017: net inflows of £2.3 billion on an actual exchange rate basis) with modestly positive retail net flows offset by higher institutional bond fund redemptions.

Operating profit based on longer-term investment returns increased 9 per cent to £2,405 million (2 per cent on an actual exchange rate basis). Operating profit from our Asia businesses increased by 14 per cent to £1,016 million driven by the compounding nature of our regular premium protection businesses. In the US, operating profit was 2 per cent higher with increased fee income offset by an expected reduction in spread earnings and a higher DAC amortisation charge. M&G Prudential's total operating profit was £778 million, 4 per cent higher than the prior year. Within this, asset management earnings increased by 10 per cent resulting from higher fees driven by higher average assets under management, and operating profit from our core with-profits and annuity life businesses were lower at £255 million (2017: £288 million), reflecting the impact of the previously announced annuity portfolio reinsurance.

Total IFRS post-tax profit was £1,356 million (2017: £1,425 million), after a £513 million anticipated pre-tax loss following the reinsurance of UK annuities to Rothesay Life, contributing to **Group IFRS shareholders' equity** of £15.9 billion (31 December 2017: £16.1 billion).

Group shareholders' Solvency II capital surplus[5,6] was estimated at £14.4 billion at 30 June 2018, equivalent to a cover ratio of 209 per cent (31 December 2017: £13.3 billion, 202 per cent). The movement since the start of the year primarily reflects the Group's continuing strong operating capital generation, partially offset by the payment of the 2017 second interim dividend.

Operating profit based on longer-term investment returns

Total operating profit increased by 9 per cent (2 per cent on an actual exchange rate basis) in the first half of 2018 to £2,405 million.

Asia total operating profit was 14 per cent higher (7 per cent on an actual exchange rate basis) at £1,016 million, and includes 13 per cent growth from Eastspring's asset management businesses. Life insurance operating profit was 14 per cent higher at £927 million, driven by continued growth in insurance margin which increased by 17 per cent, reflecting our focus on recurring premium health and protection business. This strategy underpins operating profit growth of 33 per cent and 22 per cent in Hong Kong and China respectively. Operating profit in Singapore increased 11 per cent, while the contribution from Indonesia was the same as in the first half of last year.

US total operating profit at £1,002 million increased by 2 per cent (7 per cent decrease on an actual exchange rate basis), with increased fee income driven by a 10 per cent increase in separate account balances since 30 June 2017 offset by a decline in spread income, reflecting the impact of lower yields on our fixed annuity portfolio and reduced contribution from asset duration swaps, and a higher DAC amortisation charge. The higher DAC expense arises largely from a £42 million acceleration of amortisation relating primarily to the reversal of the benefit received in 2015 under the mean reversion formula.

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UK and Europe total operating profit of £778 million was 4 per cent higher, reflecting growth of 10 per cent in asset management operating profit and 11 per cent in the UK with-profits transfer. This was partially offset by the anticipated reduction in profit from in-force annuities following the reinsurance of £12 billion[3] of annuity liabilities to Rothesay Life in March 2018. Operating earnings in the first half of 2018 also benefited from management actions of £63 million (2017: £188 million) and a £166 million insurance recovery related to the costs of reviewing internally vesting annuities sold without advice after 1 July 2008, for which a provision of £400 million had previously been established.

Life insurance profit drivers

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

Shareholder-backed policyholder liabilities and net liability flows[8]

	2018 £m Half year Actual Exchange Rate				2017 £m Half year Actual Exchange Rate			
	At 1 January	**Net liability flows9**	**Market and other movements**	**At 30 June**	**At 1 January**	**Net liability flows9**	**Market and other movements**	**At 30 June**
Asia	**37,402**	**1,463**	**(717)**	**38,148**	32,851	1,016	1,173	35,040
US	**180,724**	**82**	**4,344**	**185,150**	177,626	1,958	(1,805)	177,779
UK and Europe	**56,367**	**(1,813)**	**(12,238)**	**42,316**	56,158	(1,167)	1,500	56,491
Total Group	**274,493**	**(268)**	**(8,611)**	**265,614**	266,635	1,807	868	269,310

Focusing on the business supported by shareholder capital, which generates the majority of life profit, in the first half of 2018 net flows into our businesses reflected positive net inflows into our Asia and US operations, which have been offset by outflows from our UK and Europe operations. US net inflows remained positive, but at a lower level, reflecting a lower level of institutional business and a higher level of variable annuity surrenders as our portfolio develops. The outflow from our UK and Europe operations primarily reflects the run-off of the in-force annuity portfolio following our withdrawal from selling new annuity business and outflows from unit-linked business which is driven by more variable movements in corporate pension business. This decrease in shareholder liabilities has been partly offset by the flows into the with-profit funds of £1.8 billion as shown in the table below. Market and other movements include the £12 billion[3] reduction in policyholder liabilities arising from the classification of the annuity liabilities reinsured to Rothesay Life as held for sale. Excluding this reclassification market and other movements increased liabilities by £3.4 billion reflecting currency effects as sterling weakened over the period, partly offset by adverse market movements in the first half.

Policyholder liabilities and net liability flows in with-profits business[8,10]

2018 £m	2017 £m
Half year	Half year
Actual Exchange Rate	Actual Exchange Rate

	At 1 January	Net liability flows9	Market and other movements	At 30 June	At 1 January	Net liability flows9	Market and other movements	At 30 June
Asia	**36,437**	**2,399**	**31**	**38,867**	29,933	2,295	1,053	33,281
UK and Europe	**124,699**	**1,832**	**(675)**	**125,856**	113,146	1,574	3,729	118,449
Total Group	**161,136**	**4,231**	**(644)**	**164,723**	143,079	3,869	4,782	151,730

Policyholder liabilities in our with-profits business have increased by 2 per cent[11] to £164.7 billion in the first half of 2018, driven by growth in M&G Prudential's PruFund proposition and participating products in Asia, with

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consumers seeking protection from the impact of volatile market conditions. As returns from these funds are smoothed and shared with customers, the emergence of shareholder profit is more gradual. The business, nevertheless, remains an important source of shareholder value.

Analysis of long-term insurance business pre-tax operating profit based on longer-term investment returns by driver[12]

	Actual Exchange Rate						Constant Exchange Rate		
	2018 £m			**2017 £m**			**2017 £m**		
	Half year			**Half year**			**Half year**		
	Operating profit	**Average liability**	**Margin bps**	**Operating profit**	**Average liability**	**Margin bps**	**Operating profit**	**Average liability**	**Margin bps**
Spread income	**454**	**80,938**	**112**	583	89,314	131	543	85,504	127
Fee income	**1,320**	**172,662**	**153**	1,279	164,152	156	1,175	153,255	153
With-profits	**187**	**145,813**	**26**	172	132,701	26	170	131,600	26
Insurance margin	**1,213**			1,152			1,072		
Margin on revenues	**1,083**			1,138			1,069		
Expenses:									
Acquisition costs*	**(1,133)**	**3,322**	**(34)%**	(1,241)	3,624	(34)%	(1,154)	3,411	(34)%
Administration expenses	**(1,177)**	**257,782**	**(91)**	(1,115)	259,451	(86)	(1,040)	244,721	(85)
DAC adjustments	**154**			186			173		
Expected return on shareholder assets	**103**			103			100		
	2,204			2,257			2,108		
Share of related tax charges from joint ventures and associate13	**(18)**			(16)			(16)		
Longevity reinsurance and other management actions to improve solvency	**63**			188			188		
Insurance recoveries of costs associated with review of past annuity sales	**166**			-			-		
Operating profit based on longer-term investment returns	**2,415**			2,429			2,280		

*

The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business. APE is defined under the section 'EEV Basis, New Business Results and Free Surplus Generation' in this document.

We continue to maintain our preference for higher-quality sources of income such as insurance margin and fee income. We favour insurance margin because it is relatively insensitive to the equity and interest rate cycle and prefer fee income to spread income because it is more capital-efficient. In line with this approach, on a constant exchange rate basis, in the first half of 2018, insurance margin has increased by 13 per cent (up 5 per cent on an actual exchange rate basis) and fee income by 12 per cent (up 3 per cent on an actual exchange rate basis), while spread income declined by 16 per cent (down 22 per cent on an actual exchange rate basis). Administration expenses increased to £1,177 million (2017: £1,040 million) as the business continues to expand, including an increase in US asset-based commissions on higher separate account balances which are treated as an administrative expense in this analysis.

Asset management profit drivers

Movements in asset management operating profit are influenced primarily by changes in the scale of these businesses, as measured by funds managed both on behalf of external institutional and retail customers and our internal life insurance operations.

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Asset management external funds under management[14,15]

	2018 £m				2017 £m			
	Half year				Half year			
	Actual Exchange Rate				Actual Exchange Rate			
	At 1 January	**Net flows**	**Market and other movements**	**At 30 June**	**At 1 January**	**Net flows**	**Market and other movements**	**At 30 June**
UK and Europe	**163,855**	**3,548**	**(1,913)**	**165,490**	136,763	7,179	5,176	149,118
Asia16	**46,568**	**(863)**	**(3,335)**	**42,370**	38,042	2,273	4,281	44,596
Total asset management	**210,423**	**2,685**	**(5,248)**	**207,860**	174,805	9,452	9,457	193,714
Total asset management (including MMF)	**219,740**	**3,350**	**(5,163)**	**217,927**	182,519	9,951	9,571	202,041

Average assets under management in both our Asia and UK and Europe asset management businesses were higher compared with the prior period, and reflect positive net flows in the period in the UK and Europe, and favourable market performance over the second half of 2017.

Operating profit from **M&G Prudential** asset management increased by 10 per cent to £272 million and by 13 per cent at **Eastspring** (up 7 per cent on an actual exchange rate basis) to £89 million.

M&G Prudential's external assets under management have continued to benefit from net inflows during the period backed by strong investment performance. External net flows totalled £3.5 billion (2017: net flows of £7.2 billion), led by contributions from European investors in the Optimal Income Fund and our multi-asset fund range, and from institutional clients investing in illiquid credit and equity infrastructure strategies. The contribution from positive net flows was partly offset by negative market movements, resulting in overall external assets under management at 30 June 2018 of £165.5 billion, up 1 per cent compared with the start of the year. M&G Prudential's total assets under management at 30 June 2018 were £341.9 billion (31 December 2017: £350.7 billion) with external growth offset by lower internally managed assets following the £12 billion[3] annuity portfolio reinsurance to Rothesay Life. Operating profit increased 10 per cent to £272 million, consistent with the year-on-year increase in average assets under management and reflecting a stable cost-income ratio of 54 per cent. M&G's full year cost-income ratio is typically higher than for the first half, as its cost base is weighted towards the second half of the year (half year 2017: 53 per cent, full year 2017: 58 per cent).

Eastspring reported net outflows[16] of £0.9 billion as modest retail inflows were more than offset by higher redemptions in institutional fixed income products. Eastspring's total assets under management were stable at £138.2 billion (31 December 2017: £138.9 billion), reflecting total net flows (including those from money market funds and from assets managed for internal life operations) of £3.0 billion, offset by market and other movements. Eastspring's cost-income ratio improved to 54 per cent (2017: 55 per cent).

Other income and expenditure and restructuring costs[7]

Overall net central expenditure reduced to £391 million (2017: £407 million) as higher restructuring costs relating to the UK merger and transformation programme were balanced by a reduction in the interest payable on core borrowings.

Non-operating items[7]

Non-operating items consist of negative short-term fluctuations of £113 million (2017: £523 million), losses on the disposal of businesses and other corporate transactions of £570 million and the amortisation of acquisition accounting adjustments of £22 million (2017: £29 million) arising principally from the REALIC business acquired in 2012. Losses on the disposal of businesses and other corporate transactions include a pre-tax loss of £513 million arising from the reinsurance of a portfolio of UK and Europe annuity contracts with Rothesay Life. Further information on other transactions is given in note D1 of the unaudited condensed consolidated interim financial statements. Short-term investment fluctuations are discussed further below.

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

Operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns. In the first half of 2018 the total short-term fluctuations in investment returns relating to the life operations were negative £113 million, comprising negative £326 million for Asia, positive £244 million in the US, negative £122 million in the UK and Europe and positive £91 million in other operations[28].

Rising interest rates in many territories in Asia led to unrealised bond losses in the period, and widening credit spreads and a rise in interest rates in the UK led to losses on fixed income assets supporting the capital of the shareholder-backed annuity business. In the US, Jackson provides certain guarantees on its annuity products, the value of which would typically rise when equity markets fall and long-term interest rates decline. The 46 basis points rise in the 10 year US Treasury yield has resulted in a positive impact from the revaluation of the IFRS guarantee liabilities in the current period.

IFRS effective tax rates

In the first half of 2018, the effective tax rate on operating profit based on longer-term investment returns was 18 per cent (2017: 24 per cent). The lower rate is due mainly to the reduction in the US corporate income tax rate from 35 per cent to 21 per cent which took effect from 1 January 2018.

The effective tax rate on the total IFRS profit was 20 per cent in the first half of 2018 (2017: 17 per cent). This reflects a higher effective tax rate in Asia as a result of non-operating investment losses in the first half of 2018 which do not attract tax relief, and also a higher effective tax rate in the US as a result of generating non-operating taxable profits in the first half of 2018, compared to the non-operating taxable losses generated in the first half of 2017.

The main driver of the Group's effective tax rate overall is the mix of profits between jurisdictions with higher tax rates (such as Indonesia and Malaysia), jurisdictions with lower tax rates (such as Hong Kong and Singapore) and jurisdictions with rates in between (such as the UK and the US).

Total tax contribution

The Group continues to make significant tax contributions in the countries in which it operates, with £1,560 million remitted to tax authorities in the first half of 2018. This was lower than the equivalent amount of £1,595 million (on an actual exchange rate basis) in the first half of 2017. This reduction reflects a decrease in corporation tax payments, down from £535 million (on an actual exchange rate basis) to £305 million, partly offset by increases in payroll taxes, property taxes and taxes collected from customers. The reduction in US corporation tax payments reflects the full impact of changes in the US basis for taxing derivatives introduced in 2015 which transitioned into effect across the 2016 to 2018 tax returns.

Publication of tax strategy

In May 2018 the Group published its updated tax strategy, which in addition to complying with mandatory requirements, also included a number of additional disclosures, including a breakdown of revenues, profits and taxes for all jurisdictions where more than £5 million tax was paid. This disclosure was included as a way of demonstrating that our tax footprint (ie where we pay taxes) is consistent with our business footprint.

Group and holding company cash flows

Prudential's consolidated cash flow includes the movement in cash included within both policyholders' and shareholders' funds, such as cash in the with-profits fund. Prudential therefore believes that it is more relevant to consider individual components of the movement in holding company cash flow which relate solely to the shareholders.

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

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Cash remitted to the corporate centre in the first half of 2018 amounted to £1,111 million (2017: £1,230 million). Asia's net remittance increased to £391 million (2017: £350 million), driven by on-going business growth. Jackson's remittance was £342 million (2017: £475 million), and the UK and Europe remittance was £341 million (2017: £390 million).

Net cash remitted by the business units was used to meet central costs of £219 million (2017: £226 million) and pay the 2017 second interim ordinary dividend. Reflecting these and other movements in the period, total holding company cash at 30 June 2018 was £2,210 million compared with £2,264 million at the end of 2017.

Capital position, financing and liquidity

Capital position

Analysis of movement in Group shareholder Solvency II surplus[17]

	2018 £bn	2017 £bn	
	Half year	Half year	Full year
Solvency II surplus at 1 January	**13.3**	12.5	12.5
Operating experience	**1.8**	1.7	3.6
Non-operating experience (including market movements)	**-**	-	(0.6)
UK annuities reinsurance transaction	**0.1**	-	-
Other capital movements:			
Subordinated debt redemption	**-**	-	(0.2)
Foreign currency translation impacts	**0.1**	(0.5)	(0.7)
Dividends paid	**(0.8)**	(0.8)	(1.2)
Model changes	**(0.1)**	-	(0.1)
Estimated Solvency II surplus at end of period	**14.4**	12.9	13.3

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in the Group's shareholder Solvency II capital surplus being estimated at £14.4 billion[5,6] at 30 June 2018 (equivalent to a solvency ratio of 209 per cent) compared with £13.3 billion (202 per cent) at 31 December 2017.

Prudential's designation as a G-SII was reaffirmed on 21 November 2016. Although the Financial Stability Board did not publish a new list of G-SIIs in 2017, the policy measures set out in the Financial Stability Board's 2016 communication on G-SIIs continue to apply to the Group. As a result of this designation, Prudential is subject to additional regulatory requirements, including a requirement to submit enhanced risk management plans (such as a Group-wide Recovery Plan, a Systemic Risk Management Plan and a Liquidity Risk Management Plan) to a Crisis Management Group (CMG) comprised of an international panel of regulators.

Local statutory capital

All our subsidiaries continue to hold appropriate capital positions on a local regulatory basis. In the UK, at 30 June 2018, The Prudential Assurance Company Limited and its subsidiaries[18] had an estimated Solvency II shareholder surplus of £7.5 billion[19] (equivalent to a solvency ratio of 203 per cent) and a with-profits surplus[20] of £5.5 billion (equivalent to a solvency ratio of 244 per cent). In June 2018, the National Association of Insurance Commissioners (NAIC) in the US formally approved changes to risk based capital factors that reflect the December 2017 US tax reform. Including the impact of these changes, capital generation in the first six months of 2018, and payment of a $450 million remittance to Group, Jackson's risk based capital ratio as estimated at 30 June 2018, remained above its 2017 year-end position of 409 per cent.

Debt Portfolio

The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders' exposure to credit is concentrated in the UK annuity portfolio and the US general account, mainly attributable to Jackson's fixed annuity portfolio. The credit exposure is well diversified and 98 per cent of our UK portfolio and 96 per cent of our US portfolio are investment grade[21]. During the first half of 2018 there were no default losses in the US or the UK portfolio and reported impairments were minimal in the US portfolio.

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Financing and liquidity

Shareholders' net core structural borrowings

	2018 £m	2017 £m	
	30 June	30 June	31 December
Total borrowings of shareholder-financed operations	**6,367**	6,614	6,280
Less: Holding company cash and short-term investments	**(2,210)**	(2,657)	(2,264)
Net core structural borrowings of shareholder-financed operations	**4,157**	3,957	4,016
Gearing ratio*	**21%**	20%	20%

* Net core structural borrowings as a proportion of IFRS shareholders' funds plus net debt, as set out in note II(c) of the Additional IFRS financial information.

Our financing and central liquidity position remained strong throughout the period. Our central cash resources amounted to £2.2 billion at 30 June 2018 (31 December 2017: £2.3 billion).

In addition to its net core structural borrowings of shareholder-financed operations set out above, the Group also has access to funding via the money markets and has in place a global commercial paper programme. As at 30 June 2018, we had issued commercial paper under this programme totalling US$1,189 million.

Prudential's holding company currently has access to £2.6 billion of syndicated and bilateral committed revolving credit facilities, provided by 19 major international banks, expiring in 2022 and 2023. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 30 June 2018. The medium-term note programme, the US shelf registration programme (platform for issuance of SEC registered public bonds in the US market), the commercial paper programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential's holding company and are intended to maintain a strong and flexible funding capacity.

Movement in Shareholders' Funds

The following table sets forth a summary of the movement in Prudential's IFRS shareholder funds for the periods indicated:

	2018 £m	**2017 £m**	
	Half year	**Half year**	**Full year**
Profit after tax for the period22	**1,355**	1,505	2,389
Exchange movements, net of related tax	**69**	(224)	(409)
Cumulative exchange gain of Korea life business recycled to profit and loss account	**-**	(61)	(61)
Unrealised gains and losses on Jackson fixed income securities classified as available for sale23	**(908)**	300	486
Dividends	**(840)**	(786)	(1,159)
Other	**119**	49	175
Net (decrease) increase in shareholders' funds	**(205)**	783	1,421
Shareholders' funds at beginning of the period	**16,087**	14,666	14,666

Shareholders' funds at end of the period	**15,882**	15,449	16,087
Shareholders' value per share24	**613p**	597p	622p
Return on Shareholders' funds25	**25%**	24%	25%

Group IFRS shareholders' funds at 30 June 2018 decreased by 1 per cent[11] to £15.9 billion (31 December 2017: £16.1 billion on an actual exchange rate basis). In the first six months of 2018 the Group generated profits after tax of £1.4 billion (2017: £1.5 billion), which were more than offset by dividend payments and unrealised losses on fixed income securities held by Jackson accounted for through other comprehensive income. In the first half of the period, UK sterling weakened relative to the US dollar and various Asian currencies. With approximately 48 per cent of the Group IFRS net assets denominated in non-sterling currencies, this generated a small positive exchange rate movement on net assets in the period.

Corporate transactions

Intention to demerge the Group's UK businesses from Prudential plc and sale of £12.0 billion[3] UK annuity portfolio

The Group is making progress on its previously announced intention to demerge its UK and Europe businesses from Prudential plc, resulting in two separately-listed companies, and the preparatory transfer of the legal ownership of its Hong Kong insurance subsidiaries from The Prudential Assurance Company Limited (M&G Prudential's UK regulated insurance entity) to Prudential Corporation Asia Limited.

In March 2018, M&G Prudential announced the sale of £12.0 billion (as at 31 December 2017) of its shareholder-backed annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured these liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The reinsurance agreement became effective on 14 March 2018 and resulted in an IFRS pre-tax loss of £513 million.

The impact on Group Solvency II capital position of the reinsurance transaction at 30 June 2018 is an increase in surplus of £0.1 billion. Further information on the solvency position of the Group and The Prudential Assurance Company Limited is set out in note II(e) of the Additional IFRS financial information.

Prior to the demerger, the Group expects to rebalance its debt capital across Prudential and M&G Prudential. This will include the ultimate holding company of M&G Prudential, when established, taking on new subordinated debt and Prudential plc redeeming some of its existing debt. A proportion of the proceeds of the debt that will ultimately be held by M&G Prudential will be used by Prudential plc to enable repayment of a portion of Prudential plc's existing debt. It is currently expected that the debt re-balancing will result in M&G Prudential's parent company holding up to half of the aggregate of the Group's current outstanding core structural borrowings (£6,367 million at 30 June 2018) and borrowings from short-term securities programmes[29], which together total £7,576 million at 30 June 2018.

Entrance into Thailand mutual fund market

In July 2018 Eastspring reached an agreement to initially acquire 65 per cent of TMB Asset Management Co., Ltd. ('TMBAM'), a leading asset management company in Thailand, from TMB Bank Public Company Limited ('TMB'). Eastspring has an option to increase its ownership to 100 per cent in the future. As part of this acquisition, Eastspring has also entered into a distribution agreement with TMB to provide best-in-class investment solutions to their customers.

The acquisition of TMBAM, the fifth-largest asset manager[26] in Thailand, with £10 billion[27] of assets under management which has grown by a market leading 26 per cent compound annual growth rate over the last three years, reinforces Prudential's commitment to the Thai market. The completion of the transaction is subject to local regulatory approval.

Dividend

As in previous years, the first interim dividend for 2018 has been calculated formulaically as one third of the prior year's full year ordinary dividend. The Board has approved a first interim dividend for 2018 of 15.67 pence per share, which equates to an increase of 8 per cent over the 2017 first interim dividend.

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

Notes

1. Increase stated on a constant exchange rate basis
2. US Fee income represents asset management fees that vary with the size of the underlying policyholder funds, primarily separate account balances arising from variable annuity business, net of investment management expenses. See note I(a) of Additional IFRS financial information for basis of preparation.
3. Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.
4. Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
5. Before allowing for first interim dividend.
6. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
7. Refer to note B1.1 of the unaudited condensed consolidated interim financial statements for the break-down of other income and expenditure and other non-operating items.
8. Includes Group's proportionate share of the liabilities and associated flows of the insurance joint ventures and associate in Asia.
9. Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.
10. Includes unallocated surplus of with-profits business.
11. Comparison to 31 December 2017 on an actual exchange rate basis.
12. For basis of preparation see note I(a) of Additional IFRS financial information.
13. Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In half year 2018, the Group altered the presentation of its analysis of Asia operating profit drivers to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the margin analysis on a consistent basis as the rest of the Asia operations. Half year 2017 comparatives have been re-presented accordingly.
14. Includes Group's proportionate share in PPM South Africa and the Asia asset management joint ventures.
15. For our asset management business, the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(a) of the

Additional IFRS financial information.

16. Net inflows exclude Asia Money Market Fund (MMF) inflows of £665 million (2017: net inflows £449 million on an actual exchange rate basis). External funds under management exclude Asia MMF balances of £10,067 million (2017: £8,327 million on an actual exchange rate basis).

17. The methodology and assumptions used in calculating the Solvency II capital results are set out in note II(e) of Additional IFRS financial information.

18. The insurance subsidiaries of The Prudential Assurance Company Limited are Prudential General Insurance Hong Kong Limited, Prudential Hong Kong Limited, Prudential International Assurance plc and Prudential Pensions Limited.

19. The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's estimate of calculation of UK transitional measures reflecting operating and market conditions at each valuation date.

20. The with-profits Solvency II surplus represents the Own Funds and the Solvency Capital Requirement of UK ring-fenced funds. The estimated solvency position includes the impact of recalculated transitionals at the valuation date.

21. Based on hierarchy of Standard and Poor's Moody's and Fitch, where available and if unavailable, other rating agencies or internal ratings have been used.

22. Excluding profit for the year attributable to non-controlling interests.

23. Net of related charges to deferred acquisition costs and tax.

24. Closing IFRS shareholders' funds divided by issued shares, as set out in note II(d) of the Additional IFRS financial information.

25. Annualised operating profit after tax and non-controlling interests, as a percentage of opening shareholders' funds, as set out in note II(b) of the Additional IFRS financial information. Half year profits are annualised by multiplying by two.

26. Source: TMB Investor factsheet (as of March 2018).

27. Assets under management as at 31 March 2018.

28. Other operations include Group Head Office and Asia Regional Head Office costs, Prudential Capital and Africa.

29. Comprising £1,209 million of commercial paper and Medium Term Notes.

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

The following table shows Prudential's consolidated total revenue and consolidated total charges for the following periods.

	2018 £m	**2017 £m**
	Half year	**Half year**
Gross premiums earned	**21,341**	22,105
Outward reinsurance premiums*	**(12,961)**	(947)
Earned premiums, net of reinsurance	**8,380**	21,158
Investment return	**1,434**	20,629
Other income**	**1,105**	1,137
Total revenue, net of reinsurance	**10,919**	42,924
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(4,507)**	(35,442)
Acquisition costs and other expenditure**	**(4,535)**	(5,245)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(189)**	(216)
(Loss) gain on disposal of businesses and corporate transactions	**(57)**	61
Re-measurement of the sold Korea life business	**-**	5
Total charges, net of reinsurance and (loss) gain on disposal of businesses	**(9,288)**	(40,837)
Share of profits from joint ventures and associates, net of related tax	**102**	120
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*	**1,733**	2,207
Less tax charge attributable to policyholders' returns	**(33)**	(393)
Profit before tax attributable to shareholders	**1,700**	1,814
Total tax charge attributable to policyholders and shareholders	**(377)**	(702)
Adjustment to remove tax charge attributable to policyholders' returns	**33**	393
Tax charge attributable to shareholders' returns	**(344)**	(309)
Profit for the period	**1,356**	1,505

*

Outward reinsurance premiums of £(12,961) million includes the £(12,130) million paid during the period in respect of the reinsurance of the UK annuity portfolio. See note D1 to the unaudited condensed consolidated interim financial statements for further details.

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The half year 2017 comparative results have been re-presented from those previously published for the deduction of certain expenses against revenue following the adoption of IFRS 15 (see note A2 to the unaudited condensed consolidated interim financial statements).

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

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

(a) Earned premiums, net of reinsurance

	2018 £m	**2017 £m**
	Half year	**Half year**
Asia	**7,514**	7,454
US	**6,895**	7,829
UK and Europe	**(6,043)**	5,875
Unallocated to a segment	**14**	-
Total	**8,380**	21,158

Earned premiums, net of reinsurance, totalled £8,380 million in half year 2018, down 60 per cent from £21,158 million in half year 2017. The decrease of £12,778 million was primarily driven by declines of £11,918 million in the UK and Europe operations and £934 million in the US operations, partially offset by growth of £60 million in the Asia operations.

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Asia

Net earned premiums reflect the aggregate of single and recurrent premiums of new business sold in the year and premiums on annual business sold in previous years, net of reinsurance.

Earned premiums for Asia, net of reinsurance, of £7,514 million in half year 2018 is in line with half year 2017 (£7,454 million) on an actual exchange rate basis. Excluding the impact of exchange translation, net earned premiums in Asia increased by 8 per cent from half year 2017 to half year 2018, from £6,939 million on a constant exchange rate to £7,514 million. The growth in net earned premiums reflects the continued growth of our in-force recurring premium business. In half year 2018, total new business premiums for Asia were £2,745 million, down by £216 million from half year 2017 (£2,961 million) on an actual exchange rate basis.

United States

Earned premiums, net of reinsurance, decreased by 12 per cent from £7,829 million in half year 2017 to £6,895 million in half year 2018 on an actual exchange rate basis. Excluding the impact of exchange translation, net earned premiums in the US decreased by 4 per cent from £7,169 million on a constant exchange rate in half year 2017 to £6,895 million in 2018. Jackson's variable annuity sales declined compared with prior period which had benefited from competitor 'buy-out' activity, and increased moderately excluding this effect. This, alongside lower institutional sales, led to an overall reduction in sales.

UK and Europe

Earned premiums, net of reinsurance, for UK and Europe life business decreased by 203 per cent from positive £5,875 million in half year 2017 to negative £6,043 million in half year 2018, primarily due to the inclusion of outward reinsurance premiums of £12,130 million paid in half year 2018 as part of the transaction to sell a portion of M&G Prudential's shareholder annuity portfolio to Rothesay Life. Excluding the effect of the aforementioned reinsurance transaction, earned premiums, net of reinsurance, increased by 4 per cent reflecting higher PruFund sales led by further growth in individual pensions and income drawdown business, partly offset by lower bond sales.

(b) Investment return

	2018 £m	**2017 £m**
	Half year	**Half year**
Asia	**(1,190)**	4,803
US	**2,426**	8,336
UK and Europe*	**52**	7,363
Unallocated to a segment and intra-segment elimination*	**146**	127
Total	**1,434**	20,629

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

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

Allocation of investment return between policyholders and shareholders

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

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	2018 £m	2017* £m
	Half year	Half year
Asia		
Policyholder returns		
Assets backing unit-linked liabilities	**(540)**	1,534
With-profits business	**(533)**	2,509
	(1,073)	4,043
Shareholder returns	**(117)**	760
Total	**(1,190)**	4,803
US		
Policyholders returns - Assets held to back separate account (unit-linked) liabilities	**2,194**	8,818
Shareholder returns	**232**	(482)
Total	**2,426**	8,336
UK and Europe		
Policyholder returns		
Scottish Amicable Insurance Fund (SAIF)	**(49)**	247
Assets held to back unit-linked liabilities	**22**	1,269
With-profits fund (excluding SAIF)	**339**	5,019
	312	6,535
Shareholder returns	**(260)**	828
Total	**52**	7,363
Unallocated to a segment		
Shareholder returns	**146**	127
Group Total		
Policyholder returns	**1,433**	19,396
Shareholder returns	**1**	1,233
Total	**1,434**	20,629

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Policyholder returns

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

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

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

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

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

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

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investment returns and the level of combined charge for policyholder benefits and movement on unallocated surplus that arises from such returns.

Shareholder returns

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

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

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

Reasons for period-on-period changes in investment returns

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

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

(ii) loans and receivables, which are generally carried at amortised cost (unless designated at fair value through profit or loss).

Subject to the effect of these two exceptions, the period-on-period changes in investment returns primarily reflect the generality of overall market movements for equities, debt securities and, for UK and Europe, for investment property mainly held by with-profits funds. In addition, for Asia and US separate account business, foreign exchange rates affect the sterling value of the translated income. Consistent with the treatment applied for other items of income and expenditure, investment returns for overseas operations are translated at average exchange rates.

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Asia

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

	2018 £m	2017 £m
	Half year	Half year
Interest/dividend income (including foreign exchange gains and losses)	**784**	783
Investment (depreciation) appreciation*	**(1,974)**	4,020
Total	**(1,190)**	4,803

* Investment appreciation/depreciation comprises net realised or unrealised gains and losses on the investments.

In Prudential's Asia operations, equities and debt securities accounted for 39 per cent and 54 per cent, respectively of the total investment portfolio at 30 June 2018. The remaining 7 per cent of the total investment portfolio of Prudential Asia was primarily loans and deposits with credit institutions. The total proportion of the investment portfolio invested in equities and debt securities was similar in half year 2017. In Asia, investment returns decreased from positive £4,803 million in half year 2017 to negative £1,190 million in half year 2018. This decrease in investment returns primarily reflects unrealised investment depreciation in half year 2018 of £(1,974) million on equity and debt securities. Rising interest rates in many territories in Asia led to unrealised bond losses in the period. In addition, equity market movements were either stagnant or unfavourable across the region in half year 2018 compared to strong growth in half year 2017. These adverse movements in the returns on equities have a more significant impact on the with-profits funds and unit-linked business in Asia.

United States

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

	2018 £m	2017 £m
	Half year	Half year
Investment return of investments backing US separate account liabilities	**2,194**	8,818
Other investment return	**232**	(482)
Total	**2,426**	8,336

In the US, investment returns decreased from £8,336 million in half year 2017 to £2,426 million in half year 2018. This £5,910 million unfavourable change arose from decrease of £6,624 million in the investment return of investments backing variable annuity separate account liabilities from a gain of £8,818 million in half year 2017 to £2,194 million in half year 2018 and this decrease was partially offset by increase in other investment returns from a loss of £482 million in half year 2017 to a gain of £232 million in half year 2018. The lower separate account return was primarily due to significantly more favourable movement in the US equity markets in half year 2017 compared with half year 2018. Equity market performance in the first half of 2018 was subdued and characterised by higher levels of volatility with the S&P 500 index up 2 per cent compared to 8 per cent in half year 2017. The increase of £714 million in other investment returns primarily reflects lower losses from derivatives held to manage interest rate and equity risk exposures as discussed in note B1.2 to the unaudited condensed consolidated interim financial statements.

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UK and Europe

The table below provides an analysis of investment returns attributable to UK and Europe operations for the periods presented:

	2018 £m	2017* £m
	Half year	Half year
Interest/dividend income	**3,324**	3,478
Investment (depreciation) appreciation and other investment returns	**(3,272)**	3,885
Total	**52**	7,363

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

In Prudential's UK and Europe operations, equities, debt securities and investment properties accounted for 33 per cent, 42 per cent and 9 per cent, respectively of the total investment portfolio at 30 June 2018. The remaining 16 per cent of the total investment portfolio at 30 June 2018 comprised loans, deposits with credit institutions, investment in partnerships in investment pools and derivative assets. At 30 June 2017, the total proportion of the investment portfolio invested in equities, debt securities and investment properties was 29 per cent, 47 per cent and 8 per cent. The decrease in investment appreciation and other investment returns from a gain of £3,885 million in half year 2017 to a loss of £3,272 million in half year 2018 primarily reflects adverse movements in the debt and equity markets. Widening credit spreads and a rise in interest rates in the UK during the first half of 2018 led to losses on fixed income assets. Movements in the equity markets were also unfavourable with the FTSE 100 index down 1 per cent during the period compared to a gain in the index of 2 per cent over the same period in 2017.

Unallocated to a segment

The investment returns for unallocated to a segment and intragroup elimination increased by £19 million from a gain of £127 million in half year 2017 to a gain of £146 million in half year 2018. The returns in the period include the unrealised value movements on financial instruments and foreign exchange items.

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

	2018 £m	2017 £m
	Half year	Half year
Asia	**(4,091)**	(9,281)
US	**(6,838)**	(15,056)
UK and Europe	**6,431**	(11,105)
Unallocated to a segment	**(9)**	-
Total	**(4,507)**	(35,442)

Benefits and claims represent payments, including final bonuses, to policyholders in respect of maturities, surrenders and deaths plus changes in technical provisions (which primarily represent the movement in amounts owed to policyholders) net of any associated reinsurance. Benefits and claims are amounts attributable to policyholders (net of any recoveries due from reinsurers). The movement in unallocated surplus of with-profits funds represents the transfer to (from) the unallocated surplus each year through a charge (credit) to the income statement of the annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders.

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

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The charge for total benefits and claims and movement in unallocated surplus, net of reinsurance, of with-profits funds decreased to £4,507 million in half year 2018 from £35,442 million in half year 2017 as shown below:

	2018 £m	2017 £m
	Half year	Half year
Claims incurred, net of reinsurance	(15,681)	(15,069)
Decrease (increase) in policyholder liabilities, net of reinsurance	11,410	(19,443)
Movement in unallocated surplus of with-profits funds	(236)	(930)
Benefits and claims and movement in unallocated surplus, net of reinsurance	(4,507)	(35,442)

The charge for benefits and claims and movements in unallocated surplus, net of reinsurance of £4,507 million for half year 2018 (half year 2017: £35,442 million) shown in the table above includes the effect of accounting for investment contracts without discretionary participation features (as defined by IFRS 4) in accordance with IAS 39 to reflect the deposit nature of the arrangement.

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

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

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

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

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

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Asia

In half year 2018, the charge for benefits and claims and movement in unallocated surplus of with-profits funds totalled £4,091 million compared to £9,281 million in half year 2017, representing a decrease of £5,190 million. The amounts of the period to period change attributable to each of the underlying reasons are shown below:

	2018 £m Half year	2017 £m Half year
Claims incurred, net of reinsurance	**(2,377)**	(2,495)
Increase in policyholder liabilities, net of reinsurance	**(1,506)**	(6,291)
Movement in unallocated surplus of with-profits funds	**(208)**	(495)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(4,091)**	(9,281)

In general, the growth in policyholder liabilities in Asia over the periods shown above reflected the increase due to the combined growth of new business and the in-force books in the region.

The variations in the increases or decreases in policyholder liabilities in individual periods were however, primarily due to movement in investment returns. This was as a result of asset value movements that are reflected in the unit value of the unit-linked policies and the fluctuation of the policyholder liabilities of the Asia operations' with-profits policies with the fund's investment performance.

Accordingly, due to less favourable market returns in half year 2018 compared to half year 2017, there was a related decrease in the charge for benefits and claims in the period.

United States

Except for institutional products and term certain annuities which are classified as investment products under IAS 39, the products are accounted for as insurance contracts for IFRS reporting purposes. On this basis of reporting, deposits into these products are recorded as premiums while, withdrawals and surrenders are included in benefits and claims, and the resulting net movement is recorded under other reserve movements within benefits and claims. Benefits and claims also include interest credited to policyholders in respect of deposit products less fees charged on these policies.

In half year 2018, the accounting charge for benefits and claims decreased by £8,218 million to £6,838 million compared to £15,056 million in the same period in the prior year. The amounts of the period to period change attributable to each of the underlying reasons are described below:

	2018 £m Half year	2017 £m Half year
Claims incurred, net of reinsurance	**(7,761)**	(6,962)
Decrease (increase) in policyholder liabilities, net of reinsurance	**923**	(8,094)
Benefits and claims, net of reinsurance	**(6,838)**	(15,056)

The period-on-period movement in claims incurred for US operations as shown in the table above also includes the effect of translating the US results into pounds sterling at the average exchange rates for the relevant periods.

The charges in each period comprise amounts in respect of variable annuity and other business. The period on period movement is principally driven by the movement in the investment returns on the assets backing the variable annuity separate account liabilities, which is lower in half year 2018 compared to half year 2017 due to a relatively less favourable US equity market in the current period. In particular, the investment returns on the assets backing the variable annuity separate account liabilities decreased from £8,818 million in half year 2017 to £2,194 million in half year 2018. In addition, the decrease in policyholder liabilities in half year 2018 includes accounting value movements on the guaranteed liabilities driven by the increase in US interest rates.

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UK and Europe

The overall charge for benefits, claims and the transfer to unallocated surplus decreased from a charge of £11,105 million charge in half year 2017 to a credit of £6,431 million in half year 2018. The amounts of the period to period change attributable to each of the underlying reasons are shown below, together with a further analysis of the change in policyholder liabilities by type of business:

	2018 £m	**2017 £m**
	Half year	**Half year**
Claims incurred, net of reinsurance	**(5,537)**	(5,615)
Decrease (increase) in policyholder liabilities, net of reinsurance:		
SAIF	**391**	179
Shareholder-backed annuity business	**12,899**	523
Unit-linked and other non-participating business	**216**	(826)
With-profits (excluding SAIF)	**(1,510)**	(4,934)
	11,996	(5,058)
Movement in unallocated surplus of with-profits funds	**(28)**	(432)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**6,431**	(11,105)

Claims incurred in the UK and Europe operations of £5,537 million in half year 2018 represents a decrease from £5,615 million incurred in half year 2017.

As has been explained above, the principal driver for variations in amounts allocated to the policyholders is changes to investment returns. In half year 2018, the charge for benefits and claims is also significantly impacted by the reinsurance of £12 billion of the UK shareholder annuity liabilities to Rothesay Life as described in note D1 to the unaudited condensed consolidated interim financial statements.

In aggregate, as a result of lower market returns in half year 2018 compared to half year 2017 and the aforementioned reinsurance transaction there has been a corresponding impact on benefits and claims and movements in unallocated surplus of with-profits funds in this half year, moving from a net charge of £11,105 million in half year 2017 to a net credit of £6,431 million in half year 2018.

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

For shareholder-backed annuity business, the decrease in policyholder liabilities, net of reinsurance, of £12,376 million during half year 2018 is principally due to the reinsurance of the £12 billion annuity portfolio to Rothesay Life referred to above and also negative net flows reflecting the run-off of the remaining annuity portfolio. In addition, the decreases / (increases) in policyholder liabilities in any given period reflect the effect of altered investment yield reflected in the discount rate applied in the measurement of the liabilities and other altered assumptions where relevant, together with net flows into this line of business.

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

The part of Prudential where variations in amounts attributed to policyholder liabilities and unallocated surplus are most significant is the UK and Europe's with-profits business (excluding SAIF). As explained in note C4.2 to the consolidated financial statements for the year ended 31 December 2017, the liabilities for UK and Europe's with-profits policyholders are determined on an asset-share basis that incorporates the accumulation of investment returns and all other items of income and outgoings that are relevant to each policy type. Accordingly, the movement in policyholder liabilities in the income statement will fluctuate with the investment return of the fund. Separately, the excess of assets over liabilities of the fund represents the unallocated surplus. This surplus will also fluctuate on a similar basis to the market value movement on the investment

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assets of the fund with the movement reflected in the income statement. In addition, other items of income and expenditure affect the level of movement in policyholder liabilities (to the extent reflected in assets shares) and unallocated surplus.

The correlation between total net income (loss) before benefits and claims and movement in unallocated surplus, on the one hand, and the (charge) credit for benefits and claims and movement in unallocated surplus, on the other, for UK and Europe's component of the PAC with-profits fund (excluding SAIF) principally arises due to the following factors:

(a) Investment return is included in full in the income statement and is attributable either to contracts or unallocated surplus.

(b) Investment return, to the extent attributable to contracts, directly affects asset-share liabilities, which are reflected in the income statement through changes in policyholder liabilities.

(c) Investment return, to the extent attributable to unallocated surplus, forms the majority part of the movement in such surplus in the income statement.

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

The surplus for distribution in future years will reflect the aggregate of policyholder bonuses and the cost of bonuses attributable to shareholders, which is currently set at 10 per cent of the total bonus. In general, the policyholder bonuses comprise the aggregate of regular and final bonuses. When determining policy payouts, including final bonuses, Prudential considers asset shares of specimen policies. Where policies are invested in one of the PruFund Range of Funds, policy payouts are based on the smoothed unit price of the selected investment fund.

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

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

Unallocated to a segment

Unallocated to a segment comprises the benefits and claims related to Africa operations.

(d) Acquisition costs and other expenditure

	2018 £m	2017* £m
	Half year	Half year
Asia	**(1,771)**	(2,091)
US	**(1,326)**	(1,208)
UK and Europe	**(1,208)**	(1,734)
Unallocated to a segment and intra-segment elimination	**(230)**	(212)
Total**	**(4,535)**	(5,245)

*

The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

**

The half year 2017 comparative results have been re-presented following the adoption of IFRS 15 as described in note A2 to the unaudited condensed consolidated interim financial statements.

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Total acquisition costs and other expenditure of £4,535 million in half year 2018 were 14 per cent lower than the £5,245 million incurred in half year 2017. In general, acquisition costs and other expenditure comprise acquisition costs incurred for insurance policies, change in deferred acquisition costs, operating expenses and movements in amounts attributable to external unit holders. Movements in amounts attributable to external unit holders of consolidated investment funds reflect the change in the overall returns in these funds in the period that is attributable to third-parties.

Asia

Total acquisition costs and other expenditure for Asia in half year 2018 was £1,771 million representing a decrease of £320 million compared with £2,091 million in half year 2017. The decrease of £320 million includes a favourable exchange translation impact of £157 million. Excluding the currency volatility, the total acquisitions and other expenditure decreased by £163 million from half year 2017 to half year 2018.

United States

Total acquisition costs and other expenditure for the US of £1,326 million in half year 2018 represented an increase of £118 million against the £1,208 million incurred in half year 2017. The increase of £118 million includes a favourable exchange translation impact of £102 million. Excluding the currency volatility, total acquisition costs and other expenditure increased by £220 million from half year 2017 to half year 2018. Expenses fluctuate period on period due to the amortisation of deferred acquisition costs varying with the level of short-term fluctuations in investment returns. In half year 2018 total amortisation charge of deferred acquisition costs was £474 million higher than in half year 2017. This was offset by a reduction of £305 million of charges for broker-dealer fees in half year 2018, compared to half year 2017, following the exit of the US broker-dealer business announced in 2017.

UK and Europe

Total acquisition costs and other expenditure for the UK and Europe decreased by 30 per cent from £1,734 million in half year 2017 to £1,208 million in half year 2018. This decrease arose primarily from the decrease in the charge for investment gains attributable to external unit-holders relating to funds managed on behalf of third parties which are consolidated but have no recourse to the Group, such charges decreased by £610 million from £670 million in half year 2017 to £60 million in half year 2018.

Unallocated to a segment and intra-segment elimination

Other net expenditure, including elimination of intra-segment income and expenditures, represented a charge of £230 million in half year 2018 compared to a charge of £212 million in half year 2017.

Exchange Rate Information

Prudential publishes its consolidated financial statements in pounds sterling. References in this document to 'US dollars', 'US$', '$' or '¢' are to US currency, references to 'pounds sterling', '£', 'pounds', 'pence' or 'p' are to UK currency (there are 100 pence to each pound) and references to 'Euro' or '€' are to the single currency adopted by the participating members of the European Union. The following table sets forth for each period the average of the noon buying rates on the last business day of each month of that period, as certified for customs purposes by the Federal Reserve Bank of New York, for pounds sterling expressed in US dollars per pound sterling for each of the reported periods. Prudential has not used these rates to prepare its condensed consolidated interim financial statements.

Period	Average rate
Six months ended 30 June 2017	1.26
Twelve months ended 31 December 2017	1.29
Six months ended 30 June 2018	1.37

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

	High	Low
February 2018	1.42	1.38
March 2018	1.42	1.38
April 2018	1.43	1.38
May 2018	1.36	1.33
June 2018	1.34	1.31
July 2018	1.33	1.30

On 3 August 2018, the latest practicable date prior to this filing, the noon buying rate was £1.00 = $1.30.

EEV Basis, New Business Results and Free Surplus Generation

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

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

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

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

Additional Information on Liquidity and Capital Resources

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

Liquidity sources

The parent company including the central finance subsidiaries held cash and short-term investments of £2,210 million as at 30 June 2018 and £2,264 million as at 31 December 2017. The sources of cash in half year 2018 included dividends, loans and net cash amounts received from operating subsidiaries. Prudential received £1,111 million in net cash remittances from business units in half year 2018, compared with £1,230 million received in half year 2017. These remittances primarily comprise dividends from business units and the shareholders' statutory transfer from The Prudential Assurance Company Limited long-term with-profits fund (UK Life Fund) relating to earlier bonus declarations.

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Dividends, loans and net cash amounts received from subsidiaries

Under UK company law, dividends can only be paid if a company has distributable reserves sufficient to cover the dividend. In The Prudential Assurance Company Limited, Prudential's largest operating subsidiary, distributable reserves arise from the emergence of profits from the company's long-term business. For the company's with-profits business the profits reflect the profit transfer to shareholders that occurs upon the declaration of bonuses to policyholders of with-profit products. Prudential's insurance and fund management subsidiaries' ability to pay dividends and loans to the parent company is restricted by various laws and regulations. Jackson is subject to state laws that limit the dividends payable to its parent company. Dividends in excess of these limitations generally require approval of the state insurance commissioner. The table below shows the dividends, loans and other net cash amounts received by Prudential from the principal operating subsidiaries for the first half of 2018 and 2017:

	2018 £m	**2017 £m**
	Half year	**Half year**
Asia	**391**	350
US	**342**	475
UK and Europe*	**341**	390
Other UK (including Prudential Capital)*	**37**	15
Total	**1,111**	1,230

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

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

Consolidated Cash Flows

The discussion that follows is based on the consolidated statement of cash flows prepared under IFRS and presented in Prudential's unaudited condensed consolidated interim financial statements.

Net cash outflows in the first half of 2018 were £2,271 million. This amount comprised outflows of £731 million from operating activities, outflows of £415 million from investing activities and outflows of £1,125 million from financing activities. During the first half of 2017 net cash outflows were £140 million comprising inflows of £90 million from operating activities and inflows of £757 million from investing activities less outflows of £987 million from financing activities.

As at 30 June 2018, the Group held cash and cash equivalents of £8,450 million compared with £10,690 million at 31 December 2017, a decrease of £2,240 million (representing net cash outflows of £2,271 million outlined above, and the effect of exchange rate changes of £31 million).

Contingencies and Related Obligations

Details of the main changes to Prudential's contingencies and related obligations that have arisen in the six-month period ended 30 June 2018 are set out in note D2 to the unaudited condensed consolidated interim financial statements.

Derivative Financial Instruments

Details of the uses of derivative financial instruments by Prudential are as provided in the Group's 2017 annual report on Form 20-F.

GROUP RISK FRAMEWORK

Our Group Risk Framework and risk appetite have allowed us to control our risk exposure successfully throughout the year. Our governance, processes and controls enable us to deal with uncertainty effectively, which is critical to the achievement of our strategy of helping our customers achieve their long-term financial goals.

This section explains the main risks inherent in our business and how we manage those risks, with the aim of ensuring an appropriate risk profile is maintained.

1. Introduction

Group structure

In August 2017 the Group announced its intention to combine M&G and our UK life business to form M&G Prudential, allowing the scale and capabilities in these businesses to be leveraged more effectively. In March 2018, the intention to demerge the combined business unit from the rest of the Group was announced, with the aim of focusing on meeting customers' rapidly evolving needs and to deliver long-term value to investors as two separate businesses.

The merger activity ongoing at M&G Prudential and its planned separation from the rest of the Group requires significant and complex changes. The Group Risk function is embedded within key work streams and a clear view exists of the objectives, risks and dependencies involved in order to execute this change agenda. A mature and well-embedded risk framework is in place and, during this period of transition, the Group Risk function has a defined role in providing oversight, support and risk management, as well as providing objective challenge to ensure the Group remains within risk appetite. Looking further ahead, a key objective is that post demerger there are two strong, standalone risk functions in M&G Prudential and Prudential plc. The Group will continue to increase its risk management focus on Prudential Africa as the business there grows in materiality.

Societal developments

Focus in western economies is increasingly shifting from the goods and services businesses deliver to customers towards the way in which such business is conducted and how this impacts on the wider society. In undertaking its business, the Group actively considers the environmental, social and governance (ESG) impact of our activities. The risks and opportunities arising from these are broad and may initially seem unconnected. These connections are being made by Prudential as we manage and maintain the sustainability of the business for all our stakeholders, and risk management focus is increasing on the associated transition, reputational and liability risks. Stakeholder and regulatory expectations of the Group's ESG activities also are increasing. Recent regulatory developments such as the EU General Data Protection Regulation (GDPR) have underlined that personal data must be held securely and also that its use is transparent to the data owner. Risks around the security and use of personal data are actively managed by the Group, and the recent regulatory changes in data protection in the US and Europe have been incorporated into the principles against which the business requirements are defined.

The world economy

The global economy has seen steady and broad growth through the second half of 2017 and first half of 2018, supported by accommodative monetary conditions around the world and improving economic data. Looking to the end of the first half of the year, some signs are appearing of a divergence between the US economy, which has remained relatively buoyant, and other economies around the world, which have started to show signs of slowdown. In the UK, the outcome of negotiations on the final terms of the UK's relationship with the EU is currently unknown. In the US, the Federal Reserve continues its process to normalise interest rates and monetary policy. However, the economic outlook for the world remains uncertain. There has been a long period of economic expansion (relative to recent historical levels) and there are certain risks to this trend which we are mindful of. These include the impact of tightening financial conditions and the anticipated withdrawal of central bank liquidity which may affect emerging economies and companies with high levels of debt in particular, which consequently may then have wider impacts. Political tensions in Europe, geopolitical developments and global trade tensions also pose risks to global growth.

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Financial markets

Asset valuations are currently quite high, particularly in the US, supported by some of the highest rates of earnings growth seen in recent years. Equity market volatility has remained low compared with historical levels, despite a spike in early February 2018. Interest rates have broadly increased since the middle of 2016, as central banks across the world gradually normalise monetary policy and move away from quantitative easing, although long-term interest rates have been less responsive which is leading to flattening yield curves. Credit spreads also remain narrow compared with historical levels, although some moderate widening has been seen since the beginning of the year. Financial markets remain particularly vulnerable to an abrupt change in sentiment or broad changes in trend, in particular if some of the risks to the global economy noted above were to materialise.

Political landscape

Events in recent years indicate that the world is in a period of global geopolitical transition and increasing uncertainty. Popular discontent appears to be one of the driving factors of political change, and the liberal norms and the role of multilateral rules-based institutions that underpin global order, such as the UN, NATO and WTO, appear to be evolving. Across the Group's key geographies, we are increasingly seeing national protectionism in trade and economic policies. As a global organisation, we develop plans to mitigate business risks arising from this shift and engage with national bodies where we can in order to ensure our policyholders are not adversely impacted. It is clear, however, that the full long-term impacts of these changes remain to be seen.

Regulations

Prudential operates in highly regulated markets across the globe, and the nature and focus of regulation and laws remains fluid. A number of national and international regulatory developments are in progress, with an increasing focus on systemic risks and macro-prudential policy. As well as managing the resulting changes and ensuring compliance that regulations require of us, changes in administration, particularly in the US, have resulted in uncertainty on the implementation of some regulatory policy initiatives that we are planning for, such as those purporting to introduce fiduciary obligations on distributors of investment products. Such developments will continue to be monitored at a national and global level and form part of Prudential's engagement with government policy teams and regulators.

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2. Key internal, regulatory, economic and (geo)political events over the past 12 months

Q3 2017

In August 2017 the Group's intention to combine M&G and its UK life business to form M&G Prudential is announced, allowing better leveraging of our scale and capabilities.

The UK Conservative Party begins Q3 with a confidence-and-supply arrangement with the Democratic Unionist Party, after a snap general election called by Prime Minister May in June 2017.

Companies and organisations reassess the traditional conceptions of the nature of potential cyber threats, after the systemic WannaCry and NotPetya ransomware attacks which occurred during Q2 2017.

The US Federal Reserve raises interest rates and announces a programme to normalise monetary policy.

Tensions in the South China Sea are elevated. US 'freedom of operation' exercises result in a temporary increase in proximity of American military to disputed islands in the South China Sea.

Q4 2017

In December 2017 the UK and EU agree to move negotiations onto the future trading arrangements after the UK's exit from the bloc. This remains unclear, although an agreement on transitional arrangements was subsequently agreed in March 2018.

The US Tax and Jobs Act, is signed into law by the US administration in December 2017 and it comes into force on 1 January 2018.

In November 2017, the Bank of England raises base interest rates for the first time since 2007.

In October 2017 Catalonia's independence referendum causes market turmoil in Spanish equities. Madrid takes measures to strengthen power in the region.

Q1 2018

In March 2018 the intention to demerge M&G Prudential from the rest of the Group is announced. £12 billion of annuity liabilities in our UK and Europe business are reinsured to Rothesay Life Plc, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019.

US equity markets decline rapidly, triggering a global sell-off, with the Dow Jones Industrial Average falling by circa 3,000 points in just two weeks.

President Xi Jinping enters a second term in office in China after election by the National People's Congress in March 2018.

A coalition government is formed in Italy between the centre right League and anti-establishment Five Star Movement, after general elections in March 2018.

The US administration proposes initial trade tariff measures (with additional proposals announced over H1 2018), raising trade tensions with its key G7 partners and China.

Eastspring becomes the third Prudential signatory, after M&G and PPMSA, to the UN Principles for Responsible Investment in February 2018.

Q2 2018

The General Data Protection Regulation (GDPR) goes live in the EU on 25 May 2018, increasing the rights of individuals over the use of their personal information by companies.

US President Trump and North Korean Chairman Kim Jong Un meet in Singapore on 12 June 2018 for a historic summit, where denuclearisation of the Korean peninsula is discussed.

The US Department of Labor's (DoL's) fiduciary rule is effectively ended after a decision in the US courts in March 2018. The deadline for the DoL to appeal lapses in June. Other proposals, such as the US Securities and Exchanges Commission's best interest standard, remain in progress.

The opposition Pakatan Harapan coalition win power in Malaysia following general elections held in May 2018.

The 22nd round of talks on the Regional Comprehensive Economic Partnership (RCEP) are held in Singapore between 28 April and 8 May 2018, the goal being to create the world's largest economic bloc.

The Indonesia President approves regulations on grandfathering foreign ownership of insurance companies.

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3. Managing the risks in implementing our strategy

This section provides an overview of the Group's strategy, the significant risks arising from the delivery of this strategy and the risk management focus for the following 12 months. The risks outlined below, which are not exhaustive, are discussed in more detail in sections 5 and 6.

Our strategy

Asia

'Significant protection gap and investment needs of the

middle class.'
Leading pan-regional franchise.

US
'Transition of "baby-boomers" into retirement.'

Premier retirement income player.

UK and Europe

"'Savings gap" and ageing population in need of returns/

income.'
Well-recognised brands with a strong track record of a long-term conviction-led investment approach.

Group-wide
We have announced our intention to demerge our UK and

Europe business, M&G Prudential, resulting in two

Significant risks in the delivery of the strategy

Persistency risk

Morbidity risk

Regulatory risk, including foreign ownership

Financial risks

Policyholder behaviour risk

M&G Prudential merger and transformation risk

Longevity risk

Customer risk

Transformation risks around key change programmes

Information security and data privacy risks separately listed companies with distinct investment prospects.

Group-wide regulatory risks

Environmental, social and governance (ESG) risks

4. Risk governance

a. System of governance

Appropriately managed risks allow Prudential to take business opportunities and enable the growth of its business. Effective risk management is therefore fundamental in the execution of the Group's business strategy. Prudential's approach to risk management must be both well embedded and rigorous, and, as the economic and political environment in which we operate changes, it should also be sufficiently broad and dynamic to respond to these changes.

Prudential has in place a system of governance that promotes and embeds a clear ownership of risk, processes that link risk management to business objectives, a proactive Board and senior management providing oversight of risks, mechanisms and methodologies to review, discuss and communicate risks, and risk policies and standards to ensure risks are identified, measured, managed, monitored and reported.

How risk is defined

Prudential defines 'risk' as the uncertainty that is faced in implementing the Group's strategies and objectives successfully, and includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Group. Accordingly, material risks will be retained selectively when it is considered that there is value in doing so, and where it is consistent with the Group's risk appetite and philosophy towards risk-taking.

How risk is managed

Risk management is embedded across the Group through the Group Risk Framework, which details Prudential's risk governance, risk management processes and risk appetite. The Framework has been developed to monitor and manage the risks to our business and is owned by the Board. The aggregate Group exposure to its key risk drivers is monitored and managed by the Group Risk function which is responsible for reviewing, assessing, providing oversight and reporting on the Group's risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

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In 2018 the Group has continued to update its policies and processes around new product approvals, management of critical third party arrangements and oversight of model risks. Our transformation risk framework is being applied directly to manage programme delivery risks.

The following section provides more detail on our risk governance, risk culture and risk management process.

b. Group Risk Framework

i.

Risk governance and culture

Prudential's risk governance comprises the Board, organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that the Group Head Office and the business units establish to make decisions and control their activities on risk-related matters. It includes individuals, Group-wide functions and committees involved in overseeing and managing risk.

The risk governance structure is led by the Group Risk Committee, supported by independent non-executives on risk committees of material subsidiaries. These committees monitor the development of the Group Risk Framework, which includes risk appetite, limits, and policies, as well as risk culture.

The Group Risk Committee reviews the Group Risk Framework and recommends changes to the Board to ensure that it remains effective in identifying and managing the risks faced by the Group. A number of core risk policies and standards support the Framework to ensure that risks to the Group are identified, assessed, managed and reported.

Culture is a strategic priority of the Board, who recognise its importance in the way that the Group does business. Risk culture is a subset of Prudential's broader organisational culture, which shapes the organisation-wide values that we use to prioritise risk management behaviours and practices.

An evaluation of risk culture forms part of the Group Risk Framework and in particular seeks to identify evidence that:

- Senior management in business units articulate the need for effective risk management as a way to realise long-term value and continuously support this through their actions;
- Employees understand and care about their role in managing risk they are aware of and discuss risk openly as part of the way they perform their role; and
- Employees invite open discussion on the approach to the management of risk.

The Group Risk Committee also has a key role in providing advice to the Remuneration Committee on risk management considerations to be applied in respect of executive remuneration.

Prudential's Code of Conduct and Group Governance Manual include a series of guiding principles that govern the day-to-day conduct of all its people and any organisations acting on its behalf. This is supported by specific risk policies which require that the Group act in a responsible manner. This includes, but is not limited to, policies on anti-money laundering, financial crime and anti-bribery and corruption. The Group's outsourcing and third-party supply policy ensures that human rights and modern slavery considerations are embedded across all of its supplier and supply chain arrangements. Embedded procedures to allow individuals to speak out safely and anonymously against unethical behaviour and conduct are also in place.

ii.

The risk management cycle

The risk management cycle comprises processes to identify, measure and assess, manage and control, and monitor and report on our risks.

Risk identification

Group-wide risk identification takes place throughout the year as the Group's businesses undertake a comprehensive bottom-up process to identify, assess and document its risks. This concludes with an annual top-down identification of the

Group's key risks, which considers those risks that have the greatest potential to impact the Group's operating results and financial condition and is used to inform risk reporting to the risk committees and the Board for the year.

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Our risk identification process also includes the Group's Own Risk and Solvency Assessment (ORSA), as required under Solvency II, and horizon-scanning performed as part of our emerging risk management process.

In accordance with provision C.2.1 of the UK Code, the Directors perform a robust assessment of the principal risks facing the Company through the Group-wide risk identification process, Group ORSA report and the risk assessments done as part of the business planning review, including how they are managed and mitigated.

Reverse stress testing, which requires the Group to ascertain the point of business model failure, is another tool that helps us to identify the key risks and scenarios that may have a material impact on the Group.

The risk profile is a key output from the risk identification and risk measurement processes, and is used as a basis for setting Group-wide limits, management information, assessment of solvency needs, and determining appropriate stress and scenario testing. The Group's annual set of key risks are given enhanced management and reporting focus.

Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. All quantifiable risks which are material and mitigated by holding capital are modelled in the Group's internal model, which is used to determine capital requirements under Solvency II and our own economic capital basis. Governance arrangements are in place to support the internal model, including independent validation and processes and controls around model changes and limitations.

Risk management and control

The control procedures and systems established within the Group are designed to manage the risk of failing to meet business objectives reasonably and are detailed in the Group risk policies. These focus on aligning the levels of risk-taking with the achievement of business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The management and control of risks are set out in the Group risk policies, and form part of the holistic risk management approach under the Group's ORSA. These risk policies define:

- The Group's risk appetite in respect of material risks, and the framework under which the Group's exposure to those risks is limited;
- The processes to enable Group senior management to effect the measurement and management of the Group material risk profile in a consistent and coherent way; and
- The flows of management information required to support the measurement and management of the Group's material risks and to meet the needs of external stakeholders.

The methods and risk management tools we employ to mitigate each of our major categories of risks are detailed in the further risk information section below.

Risk monitoring and reporting

The identification of the Group's key risks informs the management information received by the Group risk committees and the Board. Risk reporting of key exposures against appetite is also included, as well as ongoing developments in other key and emerging risks.

iii. Risk appetite, limits and triggers

The extent to which Prudential is willing to take risk in the pursuit of its business strategy and objective to create shareholder value is defined by a number of qualitative and quantitative expressions of risk appetite, operationalised through measures such as limits, triggers, thresholds and indicators. The Group Risk function is responsible for reviewing the scope and operation of these risk appetite measures at least annually to determine that they remain relevant. The Board approves all changes made to the Group's aggregate risk appetite, and has delegated authority to the Group Risk Committee to approve changes to the system of limits, triggers and indicators.

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Group risk appetite is set with reference to economic and regulatory capital, liquidity and earnings volatility which is aimed at ensuring that an appropriate level of aggregate risk is taken. Appetite is also defined for the Group's risks. Further detail is included in sections 5 and 6, as well as covering risks to shareholders, including those from participating and third-party business. Group limits operate within these expressions of risk appetite to constrain material risks, while triggers and indicators provide further constraint and defined points for escalation.

Earnings volatility:

The objectives of the Group's appetite and aggregate risk limits on earnings volatility seek to ensure that variability is consistent with the expectations of stakeholders; that the Group has adequate earnings (and cash flows) to service debt and expected dividends and to withstand unexpected shocks; and that earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies. The volatility of earnings is measured and monitored on IFRS operating profit and EEV operating profit bases, although IFRS and EEV total profits are also considered.

Liquidity:

The objective of the Group's liquidity risk appetite is to ensure that the Group is able to generate sufficient cash resources to meet financial obligations as they fall due in business as usual and stressed scenarios. Risk appetite with respect to liquidity risk is measured using a Liquidity Coverage Ratio which considers the sources of liquidity against liquidity requirements under stress scenarios.

Capital requirements:

Limits on capital requirements aim to ensure that the Group meets its internal economic capital requirements, achieves its desired target rating to meet its business objectives, and ensures that supervisory intervention is not required. The two measures used at the Group level are Solvency II capital requirements and internal economic capital (ECap) requirements. In addition, capital requirements are monitored on local statutory bases.

The Group Risk Committee is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is supported by the Group Risk function, which uses submissions from our local business units to calculate the Group's aggregated position (allowing for diversification effects between local business units) relative to the aggregate risk limits.

5. Summary risks

Broadly, the risks assumed across the Group can be categorised as those which arise as a result of our business operations, our investments and those arising from the nature of our products. Prudential is also exposed to those broad risks which apply because of the global environment in which it operates. These risks, where they materialise, may have a financial impact on the Group, and could also impact on the performance of its products or the services it provides to our customers and distributors, which gives rise to potential risks to its brand, reputation and have conduct risk implications. These risks are summarised below. The materiality of these risks, whether material at the level of the Group or its business units, is also indicated. The Group's disclosures covering risk factors can be found at the end of this document.

'Macro' risks

Some of the risks that the Group is exposed to are necessarily broad given the external influences which may impact on the business. These risks include:

Global economic conditions. Changes in global economic conditions can impact Prudential directly; for example, by leading to poor investment returns and fund performance, and increasing the cost of promises (guarantees) that have been made to our customers. Changes in economic conditions can also have an indirect impact on the Group; for example, leading to a decrease in the propensity for people to save and buy Prudential's products, as well as changing prevailing political attitudes towards regulation. This is a risk which is considered material at the level of the Group.

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Geopolitical risk. The geopolitical environment may have direct or indirect impacts on the Group, and has seen varying levels of volatility in recent years as seen by political developments in the UK, the US and the Eurozone. Uncertainty in these regions, combined with conflict in the Middle East, elevated tensions in east Asia and the evolving situation in the Korean peninsula underline that geopolitical risks have potentially global and wide-ranging impacts; for example, through increased regulatory and operational risks, and changes to the economic environment.

Digital disruption. The emergence of advanced technologies such as artificial intelligence and blockchain is providing an impetus for companies to rethink their existing operating models and how they interact with their customers. Digital disruption is considered from both an external and internal view. The external view considers the rise of new technologies and how this may impact on the insurance industry and Prudential's competitiveness within it, while the internal view considers the risks associated with the Group's internal developments in meeting digital change challenges and opportunities. Prudential is embracing the opportunities from new technologies, and any risks which arise from them are closely monitored.

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Risks from our investments

Credit risk
Is the potential for reduced value of Prudential's investments driven by the market's perceptions for potential for defaults of investment counterparties. The Group's asset portfolio also gives rise to invested credit risk. The assets backing the UK and Jackson annuity businesses means credit risk is considered a material risk for these business units in particular.

Market risk
Is the potential for reduced value of Prudential's investments resulting from the volatility of asset prices, driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices.

In the Asia business, the main market risks arise from the value of fees from its fee-earning products. In the US, Jackson's fixed and variable annuity books are exposed to a variety of market risks due to the assets backing these policies. The UK business' market risk exposure arises from the valuation of the shareholder's proportion of the with-profits fund's future profits, which depends on equity, property and bond values.

M&G Prudential invests in a broad range of asset classes and its income is subject to the price volatility of global financial and currency markets.

Liquidity risk
Is the risk of not having sufficient liquid assets to meet obligations as they fall due, and we look at this under both normal and stressed conditions. This is a risk which is considered material at the level of the Group.

Risks from our products

Insurance risks
The nature of the products offered by Prudential exposes it to insurance risks, which form a significant part of the overall Group risk profile.

The insurance risks that the business is exposed to by virtue of its products include **longevity risk** (policyholders living longer than expected); **mortality risk** (policyholders with life protection dying); **morbidity risk** (policyholders with health protection becoming ill) and **persistency risk** (customers lapsing their policies, and a type of policyholder behaviour risk). The medical insurance business in Asia is also exposed to **medical inflation risk** (the increasing cost of medical treatments).

The pricing of Prudential's products requires it to make a number of assumptions, and deviations from these may impact its reported profitability. Across its business units, some insurance risks are more material than others.

Persistency and morbidity risks are among the most material insurance risks for the Asia business given the focus on health protection products in the region.

For M&G Prudential the most material insurance risk is longevity risk, driven by legacy annuity business.

The Jackson business is most exposed to policyholder behaviour risk, including persistency, which impacts the profitability of the variable annuity business and is influenced by market performance and the value of policy guarantees.

Risks from our business operations

Operational risks
The complexity of the Group and its activities means it faces a challenging operating environment, resulting from the high volume of transactions it processes, its people, processes and IT systems, and the extensive regulations under which it operates. Operational risk is the risk of loss or unintended gain from inadequate or failed processes, personnel, systems and external events, and can arise through business transformation; introducing new products; new technologies; engaging in third party relationships; and entering into new markets and geographies. Implementing the business strategy requires interconnected change initiatives across the Group, the pace of which introduces further complexity. Such risks, if they materialise, could result in financial loss and/or reputational damage.

Operational risk is considered to be material at the level of the Group.

Information security and **data privacy risks** are significant considerations for Prudential, and include the continually evolving risk of malicious attack on its systems, network disruption as well as risks relating to data security, integrity, privacy and misuse. The size of its IT infrastructure and network, stakeholder expectations and high profile cyber security and data misuse incidents across industries means that these risks continue to be under high focus, and together are considered to be material at the level of the Group.

Regulatory risk
Prudential operates under the ever-evolving requirements set out by diverse regulatory, legal and tax regimes. The increasing shift towards macro-prudential regulation and the number of regulatory changes under way across Asia (in particular focusing on consumer protection) are key areas of focus, while both Jackson and M&G Prudential operate in highly regulated markets. Regulatory reforms can have a material impact on Prudential's businesses.

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6. Further risk information

In reading the sections below, it is useful to understand that there are some risks that Prudential's policyholders assume by virtue of the nature of their products, and some risks that the Company and its shareholders assume. Examples of the latter include those risks arising from assets held directly by and for the Company or the risk that policyholder funds are exhausted. This report is focused mainly on risks to the shareholder, but will include those which arise indirectly through our policyholder exposures.

6.1 Risks from our investments

a.

Market risk

The main drivers of market risk in the Group are:

- Investment risk, which arises on our holdings of equity and property investments, the prices of which can change depending on market conditions;
- Interest rate risk, which is driven by the valuation of the Prudential's assets (particularly the bonds that it invests in) and liabilities, which are dependent on market interest rates and exposes it to the risk of those moving in a way that is detrimental; and
- Foreign exchange risk, through translation of its profits and assets and liabilities denominated in various currencies, given the geographical diversity of the business.

The main investment risk exposure arises from the portion of the profits from the UK with-profits fund which the shareholders are entitled to receive; the value of the future fees from the fee-earning products in the Asia business; and from the asset returns backing Jackson's variable annuities business. Further detail is provided below.

The Group's interest rate risk is driven in the UK business by the need to match the duration of its assets and liabilities; from the guarantees of some non unit-linked investment products in Asia; and the cost of guarantees in Jackson's fixed, fixed index and variable annuity business. Further detail is provided below.

The Group has appetite for market risk where it arises from profit-generating insurance activities to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

The Group's market risks are managed and mitigated by the following:

- Our market risk policy;
- Risk appetite statements, limits and triggers;
- Our asset and liability management programmes;
- Hedging derivatives, including equity options and futures, interest rate swaps and swaptions and currency forwards;
- The monitoring and oversight of market risks through the regular reporting of management information; and
- Regular deep dive assessments.

Investment risk

In the UK business, the main investment risk arises from the assets held in the with-profits funds through the shareholders' proportion of the funds' declared bonuses and policyholder net investment gains (future transfers). This investment risk is driven mainly by equities in the funds and some hedging to protect against a reduction in the value of these future transfers is performed outside the funds. The with-profits funds' Solvency II own funds, estimated at £9.4 billion as at 30 June 2018, helps to protect against market fluctuations and is protected partially against falls in equity markets through an active hedging programme within the fund.

In Asia, the shareholder exposure to equity price movements results from unit-linked products, where fee income is linked to the market value of the funds under management. Further exposure arises from with-profits businesses where bonuses declared are based broadly on historical and current rates of return from the Asia business' investment portfolios, which include equities.

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In Jackson, investment risk arises from the assets backing customer policies. For spread-based business, including fixed annuities, these assets are generally bonds, and shareholder exposure comes from the minimum returns needed to meet the guaranteed rates that are offered to policyholders. For variable annuity business, these assets include both equities and bonds, and the main risk to the shareholder comes from the guaranteed benefits that can be included as part of these products. The exposure to this is controlled by using a derivative hedging programme, as well as through the use of reinsurance to pass on the risk to third-party reinsurers.

While accepting the equity exposure that arises on future fees, the Group has limited appetite for exposures to equity price movements to remain unhedged or for volatility within policyholder guarantees after taking into account any natural offsets and buffers within the business.

Interest rate risk

Some products that Prudential offer are sensitive to movements in interest rates. As part of the Group's ongoing management of this risk, a number of mitigating actions to the in-force business have been taken, as well as re-pricing and restructuring new business offerings in response to recent relatively low interest rates. Nevertheless, some sensitivity to interest rate movements is still retained.

The Group's appetite for interest rate risk is limited to where assets and liabilities can be tightly matched and where liquid assets or derivatives exist. Appetite for risk is limited where such liquid assets, derivatives or other offsets in the business to cover interest rate exposures do not exist.

In the UK insurance business, interest rate risk arises from the need to match the cash flows of its annuity obligations with those from its investments. Under Solvency II rules, interest rate risk also results from the requirement to include a balance sheet risk margin. The risk is managed by matching asset and liability durations as well as continually assessing the need for use of any derivatives. The with-profits business is also exposed to interest rate risk through some product guarantees. Such risk is largely borne by the with-profits fund itself although shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

In Asia, our exposure to interest rate risk arises from the guarantees of some non unit-linked investment products. This exposure exists because of the potential for asset and liability mismatch which, although it is small and managed appropriately, cannot be eliminated.

Jackson is affected by interest rate movements to its fixed annuity, fixed index annuity and variable annuity book, mainly from the impact on the cost of guarantees to the shareholder in these products which may increase when interest rates fall. The level of sales of variable annuity products with guaranteed living benefits is actively monitored, and the risk limits we have in place helps to ensure comfort with the level of interest rate and market risks incurred as a result. Derivatives are also used to provide some protection.

Foreign exchange risk

The geographical diversity of Prudential's businesses means that it has some exposure to the risk of foreign exchange rate fluctuations. The operations in the US and Asia, which represent a large proportion of operating profit and shareholders' funds, generally write policies and invest in assets in local currencies. Although this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in the Group financial statements when results are reported in UK sterling. This risk is accepted within our appetite for foreign exchange risk.

The Group has no appetite for foreign exchange risk in cases where a surplus arises in an overseas operation which is to be used to support Group capital, or where a significant cash payment is due from an overseas subsidiary to the Group. This currency exposure is hedged where it is believed to be favourable economically to do so. Further, the Group generally does not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside the countries in which it operates, but it does have some appetite for this on fee income and on non-sterling investments within the with-profits fund. Where foreign exchange risk arises outside appetite, currency borrowings, swaps and other derivatives are used to manage the exposure.

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b.

Credit risk

Prudential invests in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments needed to policyholders. It also enters into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, it is exposed to credit risk and counterparty risk across its business.

Credit risk is the potential for reduction in the value of investments which results from the perceived level of risk of an investment issuer being unable to meet its obligations (defaulting). Counterparty risk is a type of credit risk and relates to the risk that the counterparty to any contract we enter into being unable to meet their obligations causing us to suffer loss.

The Group has some appetite to take credit risk where it arises from profit-generating insurance activities, to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

A number of risk management tools are used to manage and mitigate this credit risk, including the following:

- A credit risk policy and dealing and controls policy;
- Risk appetite statements and limits that have been defined on issuers, and counterparties;
- Collateral arrangements for derivative, secured lending reverse repurchase and reinsurance transactions;
- The Group Credit Risk Committee's oversight of credit and counterparty credit risk and sector and/or name-specific reviews;
- Regular assessments; and
- Close monitoring or restrictions on investments that may be of concern.

Debt and loan portfolio

Prudential's UK business is exposed mainly to credit risk on fixed income assets in the shareholder-backed portfolio. At 30 June 2018, this portfolio contained fixed income assets worth £22.1 billion. M&G Prudential's debt portfolio reduced by £12.1 billion following the transfer of fixed income assets to Rothesay Life as part of the reinsurance agreement announced in March 2018. Credit risk arising from a further £57.6 billion of fixed income assets is borne largely by the with-profits fund, to which the shareholder is not exposed directly although under extreme circumstances shareholder support may be required if the fund is unable to meet payments as they fall due.

Credit risk also arises from the debt portfolio in the Asia business, the value of which was £42.3 billion at 30 June 2018. The majority (68 per cent) of the portfolio is in unit-linked and with-profits funds and so exposure of the shareholder to this component is minimal. The remaining 32 per cent of the debt portfolio is held to back the shareholder business.

In the general account of the Jackson business £36.1 billion of fixed income assets are held to support shareholder liabilities including those from our fixed annuities, fixed index annuities and life insurance products.

The shareholder-owned debt and loan portfolio of the Group's other operations was £2.3 billion as at 30 June 2018.

Further details of the composition and quality of our debt portfolio, and exposure to loans, can be found in the IFRS financial statements.

Group sovereign debt

Prudential also invests in bonds issued by national governments. This sovereign debt represented 20 per cent or £14.4 billion of the shareholder debt portfolio as at 30 June 2018 (31 December 2017: 19 per cent or £16.5 billion). 6 per cent of this was rated AAA and 88 per cent was considered investment grade (31 December 2017: 90 per cent investment grade).

The particular risks associated with holding sovereign debt are detailed further in our disclosures on risk factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 30 June 2018 are given in Note C3.2(f) of the Group's IFRS financial statements.

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Bank debt exposure and counterparty credit risk

Prudential's exposure to banks is a key part of its core investment business, as well as being important for the hedging and other activities undertaken to manage its various financial risks. Given the importance of its relationship with its banks, exposure to the sector is considered a material risk for the Group.

The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 30 June 2018 are given in Note C3.2(f) of the Group's IFRS financial statements.

The exposure to derivative counterparty and reinsurance counterparty credit risk is managed using an array of risk management tools, including a comprehensive system of limits. Where appropriate, Prudential reduces its exposure, buys credit protection or uses additional collateral arrangements to manage its levels of counterparty credit risk.

At 30 June 2018, shareholder exposures by rating and sector[1] are shown below:

- 95 per cent of the shareholder portfolio is investment grade rated. In particular, 66 per cent of the portfolio is rated A- and above (or equivalent); and
- The Group's shareholder portfolio is well diversified: no individual sector makes up more than 15 per cent of the total portfolio (excluding the financial and sovereign sectors).

c. Liquidity risk

Prudential's liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due. This incorporates the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may impact on market conditions and valuation of assets in a more uncertain way than for other risks like interest rate or credit risk. It may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or where redemption requests are made against Prudential external funds.

Prudential has no appetite for liquidity risk, ie for any business to have insufficient resources to cover its outgoing cash flows, or for the Group as a whole to not meet cash flow requirements from its debt obligations under any plausible scenario.

The Group has significant internal sources of liquidity, which are sufficient to meet all of our expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external sources of funding. The Group has a total of £2.6 billion of undrawn committed facilities that can be made use of, expiring in 2022 and 2023. Access to further liquidity is available through the debt capital markets and an extensive commercial paper programme in place, and Prudential has maintained a consistent presence as an issuer in the market for the last decade.

A number of risk management tools are used to manage and mitigate this liquidity risk, including the following:

- The Group's liquidity risk policy;
- Risk appetite statements, limits and triggers;
- Regular assessment at Group and business units of Liquidity Coverage Ratios which are calculated under both base case and stressed scenarios and are reported to committees and the Board;
- The Group's Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as gap analysis of liquidity risks and the adequacy of available liquidity resources under normal and stressed conditions;
- Regular stress testing;
- Our contingency plans and identified sources of liquidity;
- The Group's ability to access the money and debt capital markets;

Regular deep dive assessments; and

The Group's access to external committed credit facilities.

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6.2 Risks from our products

a.

Insurance risk

Insurance risk makes up a significant proportion of Prudential's overall risk exposure. The profitability of its businesses depends on a mix of factors including levels of, and trends in, mortality (policyholders dying), morbidity (policyholders becoming ill) and policyholder behaviour (variability in how customers interact with their policies, including utilisation of withdrawals, take-up of options and guarantees and persistency, ie lapsing of policies), and increases in the costs of claims, including the level of medical expenses increases over and above price inflation (claim inflation).

The Group has appetite for retaining insurance risks in order to create shareholder value in the areas where it believes it has expertise and controls to manage the risk and can support such risk with its capital and solvency position.

The principal drivers of the Group's insurance risk vary across its business units. At M&G Prudential, this is predominantly longevity risk. Across Asia, where a significant volume of health protection business is written, the most significant insurance risks are morbidity risk, persistency risk, as well as medical inflation risk. In Jackson, policyholder behaviour risk is particularly material, especially in the take up of options and guarantees on variable annuity business.

The Group manages longevity risk in various ways. Longevity reinsurance is a key tool in managing this risk. In March 2018, the Group's longevity risk exposure was significantly reduced by reinsuring £12 billion in UK annuity liabilities to Rothesay Life, pursuant to a full Part VII transfer of these liabilities planned for 2019. Although Prudential has withdrawn from selling new UK annuity business, given its significant annuity portfolio the assumptions it makes about future rates of improvement in mortality rates remain key to the measurement of its insurance liabilities and to its assessment of any reinsurance transactions. Prudential continues to conduct research into longevity risk using both experience from its annuity portfolio and industry data. Although the general consensus in recent years is that people are living longer, there is considerable volatility in year-on-year longevity experience, which is why it needs expert judgement in setting its longevity basis.

Prudential's morbidity risk is mitigated by appropriate underwriting when policies are issued and claims are received. Our morbidity assumptions reflect our recent experience and expectation of future trends for each relevant line of business.

In Asia, Prudential writes significant volumes of health protection business, and so a key assumption is the rate of medical inflation, which is often in excess of general price inflation. There is a risk that the expenses of medical treatment increase more than expected, so the medical claim cost passed on to Prudential is higher than anticipated. Medical expense inflation risk is best mitigated by retaining the right to re-price our products each year and by having suitable overall claim limits within its policies, either limits per type of claim or in total across a policy.

The Group's persistency assumptions reflect similarly a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. Persistency risk is mitigated by appropriate training and sales processes and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, allowance is made for the relationship (either assumed or observed historically) between persistency and investment returns and any additional risk is accounted for. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within ce