PRUDENTIAL PLC
Form 20-F
March 22, 2019

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As filed with the Securities and Exchange Commission on 22 March 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended 31 December 2018

OR

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

OR

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

Commission File Number: 1-15040

PRUDENTIAL PUBLIC LIMITED COMPANY
(Exact Name of Registrant as Specified in its Charter)

England and Wales
(Jurisdiction of Incorporation)

12 Arthur Street,
London EC4R 9AQ, England
(Address of Principal Executive Offices)

Rebecca Wyatt
Director of Group Financial Accounting & Reporting
Prudential plc
12 Arthur Street,
London EC4R 9AQ, England
+44 20 7220 7588
rebecca.wyatt@prudential.co.uk
(Name, telephone, e-mail and/or facsimile number and address of company contact person)

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

Title of Each Class	Name of Each Exchange on Which Registered
American Depositary Shares, each representing 2 Ordinary Shares, 5 pence par value each	New York Stock Exchange
Ordinary Shares, 5 pence par value each	New York Stock Exchange*
6.75% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Denominated Preference Shares	New York Stock Exchange
6.50% Perpetual Subordinated Capital Securities Exchangeable at the Issuer's Option into Non-Cumulative Dollar Denominated Preference Shares	New York Stock Exchange

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

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

The number of outstanding shares of each of the issuer's classes of capital or common stock as of 31 December 2018 was:

2,593,044,409 Ordinary Shares, 5 pence par value each

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes X No __

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes __ No X

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the

past 90 days.

Yes _X_ No __

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

Yes _X_ No __

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer _X_ Accelerated filer __ Non-accelerated filer __ Emerging growth company __

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected to not use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Yes __ No __

The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP __ International Financial Reporting Standards as issued by the International Accounting Standards Board _X_ Other ___

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 __ Item 18 __

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes __ No _X_

*

Not for trading, but only in connection with the registration of American Depositary Shares.

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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' or the 'parent company' each refer to 'Prudential plc'.

This 2018 Annual Report may include references to our website. Information on our website or any other website referenced in the Prudential 2018 Annual Report is not incorporated into this Form 20-F and should not be considered to be part of the Form 20-F. We have included any website as an inactive textual reference only.

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FORWARD-LOOKING STATEMENTS

This document may contain 'forward-looking statements' with respect to certain of Prudential's plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations and including, without limitation, statements containing the words 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', '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&GPrudential 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&GPrudential 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 document, as well as under the 'Risk Factors' heading of any subsequent Prudential Half Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K.

Any forward-looking statements contained in this document speak only as of the date on which they are made. Prudential expressly disclaims any obligation to update any of the forward-looking statements contained in this document or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, the Hong Kong Listing Rules, the SGX-ST listing rules or other applicable laws and regulations. Prudential may also make or disclose written and/or oral forward-looking statements in reports filed with or furnished to the US Securities and Exchange Commission, the UK Prudential Regulation Authority and UK 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 document, as well as under the 'Risk Factors' heading of any subsequent filing Prudential makes with the US Securities and Exchange Commission, including any subsequent Half Year Financial Report on Form 6-K. These factors are not exhaustive as Prudential operates in a continually changing business environment with new risks emerging from time to time that it may be unable to predict or that it currently does not expect to have a material adverse effect on its business.

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SUMMARY OF OUR BUSINESS

Group at A Glance

Prudential is an international financial services group serving over 26 million customers and with £657 billion of assets under management (as at 31 December 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. or its subsidiary, The Prudential Insurance Company of America, whose principal place of business is in the US.

We meet the long-term savings and protection needs of a growing middle-class and ageing population. We focus on markets where the need for our products is strong and growing and we use our capabilities, footprint and scale to meet that need. In 2018, the Group announced its intention to demerge its UK and Europe business, M&GPrudential, from Prudential plc, which will result in two separately listed companies, with different investment characteristics and opportunities. We have always been clear about the importance of creating optionality in our corporate structure, and decided to exercise one of those options in the interest of both the businesses and all of our stakeholders.

Our purpose

Prudential helps people de-risk their lives and deal with their biggest financial concerns.

Our strategy

Our strategy is to capture the long-term structural opportunities within our markets, operating with discipline and enhancing capabilities through innovation to deliver high-quality resilient outcomes for our customers.

We aim to do this by:

- Serving the protection and investment needs of the growing middle class in Asia;
- Providing asset accumulation and retirement income products to US baby boomers;
- Offering products to new customers in Africa, one of the fastest-growing regions in the world; and
- Meeting the savings and retirement needs of an ageing UK and continental European population.

We aim to generate attractive returns enabling us to provide financial security to our customers and deliver sustainable growth for our shareholders. Following rigorous review, we believe that this long-term strategy is best served through the intended demerger of M&GPrudential. The demerger will enable both businesses to continue to deliver on our customer and stakeholder commitments, but without the requirement to compete for resources and capital internally.

Prudential plc	Structural growth over the last two decades has allowed our non-European business to reach the scale where it has the ability to self-fund its own long-term goals through disciplined capital allocation. Prudential plc has a diversified, but highly complementary, portfolio of businesses with access to the world's largest and fastest-growing markets.
Asia Prudential Corporation Asia	Prudential Corporation Asia has leading insurance and asset management operations across 14 markets which serve the families of the region's high potential economies. We have been operating in Asia for over 90 years and have built high-performing businesses with multichannel distribution, a product portfolio centred on regular savings and protection, award-winning customer service and a widely recognised brand.

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

United States Jackson

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

Africa

We entered Africa in 2014, to offer products to new customers in one of the fastest-growing regions in the world. We aim to provide products that help our customers to live longer and healthier lives, and save to improve future choices for them and their families.

UK and Europe M&GPrudential

The formation of M&GPrudential, the joining of two well recognised brands with a strong track record, has created a leading savings and investment business, ideally positioned to target growing customer demand for financial solutions in the UK and Europe.

With over 6 million clients across 29 markets and £321 billion[1] in assets under management, M&GPrudential's vision is a business built for the customer which is simple, efficient, digitally enabled, capital-light, fast-growing and, above all, focused on delivery.

The combined business benefits from two strong complementary brands, a world-class investment capability, international distribution and a robust capital position.

1 Represents M&GPrudential asset management external funds under management and internal funds included on the M&GPrudential long-term insurance balance sheet.

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Demerger update

Creating two leading companies

We are aiming to create two separately listed companies with distinct investment prospects, capital allocation priorities and customer needs.

M&GPrudential, one of the leading savings and investments businesses in the UK and Europe, will be an independent, capital-efficient business, headquartered and premium-listed in London.

Prudential plc will continue to combine the exciting growth potential of our Asia, US and Africa businesses, as a leading international insurance and asset management group. We will also remain headquartered and premium listed in London.

Frequently asked questions

What is the rationale for the demerger?

Following separation, M&GPrudential will have more control over its business strategy and capital allocation. This 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, while Prudential plc will be able to focus on the attractive returns and growth potential of its market-leading businesses in Asia and the US.

Will the businesses stay in the UK?

Both businesses will be headquartered in the UK, and premium-listed on the London Stock Exchange. We expect both businesses will meet the criteria for inclusion in the FTSE 100 index.

How are we progressing?

In preparation for the demerger, we have already completed a number of key steps, including:

- We announced that the Hong Kong Insurance Authority would be the Group-wide supervisor after the demerger of M&GPrudential;

We raised £1.6 billion of debt in September 2018. This debt issuance contained a substitution clause, allowing us to substitute M&GPrudential for Prudential plc as the issuer;

We established a new holding company for M&GPrudential and completed the transfer of the legal ownership of The Prudential Assurance Company Limited and M&G Group Limited to this company;

We announced the independent Chair of M&GPrudential in October 2018; and

We completed the transfer of the legal ownership of our Hong Kong insurance subsidiaries from The Prudential Assurance Company Limited (M&GPrudential's UK-regulated insurance entity) to Prudential Corporation Asia Limited.

When will it happen?

We are making good progress on the workstreams to enable the legal, operational and financial separation of the businesses and we are committed to delivery with best execution. We will provide more details on timing when it is appropriate to do so.

What will happen to your shares?

Shareholders will retain their shares in Prudential plc and, if the demerger completes, receive shares in a separately listed M&GPrudential.

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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 audited consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2018, there were no unendorsed standards effective for the years 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 audited consolidated financial statements is derived from audited consolidated financial statements prepared in accordance with IFRS as issued by the IASB. This table is only a summary and should be read in conjunction with Prudential's consolidated financial statements and the related notes included elsewhere in this document, together with the disclosures in the 'Financial Review' section.

Income statement data

	2018 $m(1)	**2018 £m**	**2017 £m**	**2016 £m**	**2015 £m**	**2014 £m**
Gross premiums earned	**60,272**	**47,224**	44,005	38,981	36,663	32,832
Outward reinsurance premiums	**(17,898)**	**(14,023)**	(2,062)	(2,020)	(1,157)	(799)
Earned premiums, net of reinsurance	**42,374**	**33,201**	41,943	36,961	35,506	32,033
Investment return	**(13,099)**	**(10,263)**	42,189	32,511	3,304	25,787
Other income(8)	**2,544**	**1,993**	2,258	2,246	2,356	2,137
Total revenue, net of reinsurance	**31,819**	**24,931**	86,390	71,718	41,166	59,957
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(16,041)**	**(12,568)**	(72,532)	(59,366)	(29,656)	(50,169)
Acquisition costs and other expenditure(8)	**(11,302)**	**(8,855)**	(9,993)	(8,724)	(8,069)	(6,583)
Finance costs: interest on core structural borrowings of shareholder-financed businesses	**(523)**	**(410)**	(425)	(360)	(312)	(341)
(Loss) gain on disposal of businesses and corporate transactions	**(102)**	**(80)**	223	-	(46)	(13)
Re-measurement of the sold Korea life business	**-**	**-**	5	(238)	-	-
Total charges, net of reinsurance and (loss) gain on disposal of businesses	**(27,968)**	**(21,913)**	(82,722)	(68,688)	(38,083)	(57,106)
Share of profits from joint ventures and associates, net of related tax	**371**	**291**	302	182	238	303
Profit before tax (*being tax attributable to shareholders' and policyholders' returns*)(2)	**4,222**	**3,309**	3,970	3,212	3,321	3,154
Tax credit (charges) attributable to policyholders' returns	**416**	**326**	(674)	(937)	(173)	(540)
Profit before tax attributable to shareholders	**4,638**	**3,635**	3,296	2,275	3,148	2,614
Tax (charges) attributable to shareholders' returns	**(794)**	**(622)**	(906)	(354)	(569)	(398)

Profit for the year	**3,844**	**3,013**	2,390	1,921	2,579	2,216

Statement of financial position data	**2018 $m(1)**	**2018 £m**	**2017 £m**	**2016 £m**	**2015 £m**	**2014 £m**
Total assets	**649,184**	**508,645**	493,941	470,498	386,985	369,204
Total policyholder liabilities and unallocated surplus of with-profits funds	**542,614**	**425,146**	428,194	403,313	335,614	321,989
Core structural borrowings of shareholder-financed businesses	**9,782**	**7,664**	6,280	6,798	5,011	4,304
Total liabilities	**627,148**	**491,378**	477,847	455,831	374,029	357,392
Total equity	**22,038**	**17,267**	16,094	14,667	12,956	11,812

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Other data	2018	2018	2017	2016	2015	2014
Based on profit for the year attributable to the equity holders of the Company:						
Basic earnings per share	**149.2¢**	**116.9p**	93.1p	75.0p	101.0p	86.9p
Diluted earnings per share	**149.1¢**	**116.8p**	93.0p	75.0p	100.9p	86.8p
Dividend per share declared and paid in reporting period(5)						
Interim ordinary dividend/final ordinary dividend	**61.5¢**	**48.17p**	45.07p	39.40p	38.05p	35.03p
Equivalent cents per share(6)		**64.33¢**	59.28¢	55.21¢	59.11¢	58.44¢
Special dividend				10.00p		
Equivalent cents per share(6)				14.51¢		
Market price per share at end of period(7)	**1,789.4 ¢**	**1,402.0p**	1,905.5p	1,627.5p	1,531.0p	1,492.0p
Weighted average number of shares (in millions)		**2,575**	2,567	2,560	2,553	2,549
New business:						
Single premium sales(3)	**39,720**	**31,121**	31,965	27,841	27,687	24,296
New regular premium sales(3)(4)	**4,710**	**3,690**	3,762	3,536	2,697	2,107
Funds under management	**838,912**	**657,300**	669,300	602,300	508,600	496,000

Notes

(1)

Amounts stated in US dollars in the 2018 US dollar column have been translated from pounds sterling at the rate of $1.2763 per £1.00 (the noon buying rate in New York City on 31 December 2018).

(2)

This measure is the formal profit (loss) before tax measure under IFRS but is not the result attributable to shareholders. See 'Presentation of results before tax' in note A3.1(b) to Prudential's consolidated financial statements for further explanation.

(3)

The new business premiums in the table shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders (see the 'EEV Basis, New Business Results and Free Surplus Generation' section of this document). 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 year.

(5)

Under IFRS, dividends declared or approved after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event. The appropriation reflected in the statement of changes in equity, therefore, includes dividend in respect of the prior year that was declared or approved after the balance sheet date of the prior reporting period. Parent company dividends relating to the reporting period were a first interim ordinary dividend of 15.67p per share in 2018 (2017: 14.50p, 2016: 12.93p), a second interim ordinary dividend of 33.68p per share in 2018 (2017: 32.50p, 2016: 30.57p).

(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 2014 to 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 consolidated 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 consolidated financial statements and the related notes for the year ended 31 December 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 any future periods. This discussion contains forward-looking statements based on current expectations, which involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in these forward-looking statements due to a number of factors, including those set forth in the 'Risk Factors' and elsewhere in this document.

We have delivered another year of positive financial performance across the Group. Through the combination of our consistent strategy, our diversified portfolio of businesses and our disciplined execution, we have continued to produce high-quality earnings and deliver consistent returns for our investors and good outcomes for all our stakeholders.

Our purpose is to help people de-risk their lives and deal with their biggest financial concerns. Whether they are starting a family, saving for a child's education or planning for old age, we provide them with the freedom to face the future with confidence through our long-term savings and protection products, retirement income solutions and asset management capabilities. At the same time, we invest our customers' savings in the real economy, helping to drive the cycle of growth and build stronger communities.

We serve this purpose through our clear, consistent strategy, which is focused on long-term structural trends and gives us unrivalled access to the world's largest and fastest-growing markets. In Asia, our distinguished brand, extensive footprint and broad product and distribution reach across 14 markets leaves us well positioned to serve the health, protection and savings needs of the rapidly growing and increasingly affluent population. We are also a leading provider of retirement products in the US, where the number of people aged 65 and older is expected to grow from 55 million in 2020 to 72 million by 2030[1], and we are continuing to enhance our product set and distribution reach to capture the opportunity in this market. In the UK and Europe, where ageing populations provide growing demand for managed savings solutions, M&GPrudential is transforming itself to meet those needs in new ways. In Africa we are building a presence in one of the world's most under-penetrated insurance markets, with operations in five markets.

We are continuing to develop our product offering and improve our capabilities in order to meet the needs of customers in all these markets. Across our businesses, we are listening to our customers and creating new and better products in response to their changing needs. At the same time, we are constantly upgrading our capabilities, including, by investing in digital technology that enables us to meet our customers' needs more quickly and efficiently.

In March 2018, we announced our intention to demerge M&GPrudential from the Group, in order to create two separately listed companies with distinct investment characteristics and opportunities. After the demerger, our shareholders will have shares in Prudential plc, which will be even better positioned to capture the structural opportunities ahead of us, and M&GPrudential, with greater freedom to deploy its capital where and how it likes to meet the changing needs of customers.

We are making good progress towards the demerger. On the structural side, we have established the holding company for M&GPrudential, and we have completed the first stages at the High Court of England and Wales for the transfer of part of the M&GPrudential annuity book to Rothesay. On the operational side, we are moving forward with separating the functions of the two businesses and building new ones to prepare M&GPrudential for its post-demerger future. We have also raised £1.6 billion of subordinated debt, with substitution clauses to be activated on demerger, supporting the capital rebalancing of the two businesses, and we continue to work with our regulators.

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 periods of currency movement. We have used this basis in discussions below for our Asian and US businesses to maintain comparability. Currency values in the countries in which we operate have fluctuated in the course of 2018.

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Our approach to evaluating the financial performance of the Group is to present 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 (alternative performance measure) of adjusted IFRS operating profit based on longer-term investment returns. Further explanation on the determination of adjusted IFRS 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 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 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

	AER			CER		AER
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**	**2016 £m**
Profit after tax for the year attributable to shareholders	**3,013**	2,390	26%	2,317	30%	1,921
Tax charge attributable to shareholders' returns	**622**	906	(31)%	876	(29)%	354
Profit before tax attributable to shareholders	**3,635**	3,296	10%	3,193	14%	2,275
Non-operating items:						
Losses from short-term fluctuations in investment returns on shareholder-backed businesses	**558**	1,563	(64)%	1,514	(63)%	1,678
Amortisation of acquisition accounting adjustments	**46**	63	(27)%	61	(25)%	76
Loss (gain) on disposal of businesses and corporate transactions	**588**	(223)	(364)%	(218)	(370)%	227
	1,192	1,403	(15)%	1,357	(12)%	1,981
Adjusted IFRS operating profit based on longer-term investment returns	**4,827**	4,699	3%	4,550	6%	4,256
Analysed into:						
Asia	**2,164**	1,975	10%	1,898	14%	1,644
US	**1,919**	2,224	(14)%	2,146	(11)%	2,048

UK and Europe	**1,634**	1,378	19%	1,378	19%	1,253
Other income and expenditure	**(890)**	(878)	1%	(872)	2%	(689)
Adjusted IFRS operating profit based on longer-term investment returns	**4,827**	4,699	3%	4,550	6%	4,256

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 on a CER basis) unless otherwise stated. In each such case, the performance of our businesses in AER terms is explained by the same factors discussed in the comments below and the impact of currency movements implicit in the CER data.

Our financial performance

Our financial performance in 2018 reflects our focus on high quality execution of our strategy, and is again led by our business in Asia.

Profit for the year after tax for 2018 is £3,013 million compared with £2,390 million for 2017 on an AER basis. The increase primarily reflects the movement in profit before tax attributable to shareholders, which has increased from a profit of £3,296 million in 2017 (on an AER basis) to a profit of £3,635 million in 2018 and a decrease in the tax charge attributable to shareholders from £906 million in 2017 to £622 million in 2018.

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On an AER basis, the increase in the total profit before tax attributable to shareholders from £3,296 million in 2017 to £3,635 million in 2018 reflects an improvement in adjusted IFRS operating profit based on longer-term investment returns of £128 million or 3 per cent, and a £211 million reduction in non-operating losses, from a loss of £1,403 million to a loss of £1,192 million. The £211 million reduction in non-operating losses primarily comprises a £1,005 million favourable change in short-term fluctuations in investment returns (from negative £1,563 million in 2017 to negative £558 million in 2018) partially offset by a £811 million increase in gains and losses on disposal of businesses and corporate transactions (from a gain of £223 million in 2017 to a loss of £588 million in 2018). The improvement of £128 million in total adjusted IFRS operating profit based on longer term investment returns on an AER basis reflects an increase in Asia (from £1,975 million to £2,164 million) and the UK and Europe (from £1,378 million to £1,634 million), partially offset by a decrease in the US (from £2,224 million to £1,919 million) and other income and expenditure (from a loss of £878 million to a loss of £890 million). The increase of £128 million or 3 per cent in the Group adjusted IFRS operating profit based on longer-term investment returns includes a positive exchange translation impact of £149 million. Excluding the effect of currency volatility, on a CER basis, Group adjusted IFRS operating profit based on longer-term investment returns increased from £4,550 million to £4,827 million, 6 per cent higher than the equivalent amount in 2017.

Group adjusted IFRS operating profit based on longer-term investment returns[3] was 6 per cent[2] higher at £4,827 million (up 3 per cent on an actual exchange rate basis). Adjusted IFRS operating profit based on longer-term investment returns from our Asia life insurance and asset management businesses grew by 14 per cent[2], reflecting continued broad-based business momentum across the region and high-quality sales, with over 85 per cent of operating income from our preferred sources of insurance income, fee income and with-profits. In the US, Jackson's total adjusted IFRS operating profit based on longer-term investment returns was 11 per cent[2] lower, with higher fee income outweighed by an increase in market-related deferred acquisition costs (DAC) amortisation expense and the anticipated reduction in spread earnings. In the UK and Europe, M&GPrudential's total adjusted IFRS operating profit based on longer-term investment returns was 19 per cent higher than the prior year, which principally reflects the benefit from updated longevity assumptions and an 11 per cent[4] increase in the shareholder transfer from the with-profits business, which includes a 30 per cent[4] increase from PruFund.

The Group's capital generation is underpinned by our large and growing in-force business portfolio, and focus on profitable business with fast payback of capital invested. Cash remittances to the Group from business units were £1,732 million (2017: £1,788 million). The Group's overall performance supported a 5 per cent increase in the 2018 full year ordinary dividend to 49.35 pence per share.

The Group remains robustly capitalised, with a 2018 year-end shareholder Solvency II cover ratio[5,6] of 232 per cent. Over the period, IFRS shareholders' funds increased by 7 per cent to £17.2 billion, reflecting profit after tax of £3,013 million (2017: £2,390 million on an actual exchange rate basis) and other movements that included dividend payments to shareholders of £1,244 million and favourable foreign exchange movements of £348 million.

In Asia, we have maintained our focus on value, whilst continuing to develop our capabilities and reach, which build scale and enhance quality. Our asset management business, Eastspring Investments, has continued to grow, with adjusted IFRS operating profit based on longer-term investment returns up 6 per cent[2] to £182 million.

In the US, Jackson remains focused on providing financial security to increasing numbers of individuals approaching or in retirement, broadening its product range and extending its distribution network, including new relationships announced with State Farm, Envestnet and DPL Financial Partners. In 2018, higher charges for deferred acquisition costs amortisation, largely as a result of equity market movements in the year, contributed to Jackson's adjusted IFRS operating profit based on longer-term investment returns being 11 per cent lower. Jackson's hedging programmes performed as expected in the period of equity market weakness experienced towards the end of 2018, contributing to an increased risk-based capital ratio at year-end of 458 per cent (2017: 409 per cent).

In the UK and Europe, both our life and asset management businesses performed well in 2018, with adjusted IFRS operating profit based on longer-term investment returns 19 per cent higher driven by a number of items that are not expected to recur at the same level including the effect from updated longevity assumptions. Our core PruFund proposition continues to perform well, with net inflows of £8.5 billion and the PruFund contribution to shareholder adjusted IFRS operating profit based on longer-term investment returns increasing 30 per cent to £55 million. M&GPrudential asset management saw net outflows of £9.9 billion from external clients, including the expected redemption of a single £6.5 billion low margin institutional mandate. Overall

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M&GPrudential assets under management[7] were £321 billion (2017: £351 billion), reflecting net outflows at M&GPrudential asset management and the impact of the £12 billion annuity reinsurance agreement announced in March 2018.

Our financial Key Performance Indicators (KPIs) continue to reflect the outcome of the Group's strategy. Our Asia life businesses are driven by growth in our recurring premium base and focus on health and protection business. Elsewhere we are benefiting from our prioritisation of fee-generating products across our Asia asset management, US variable annuity and UK and European savings and investment activities.

A clear and proven strategy

Our clear, proven strategy is key to our long-term positive performance, and is focused on strong and growing opportunities in Asia, the US, the UK and Europe and our nascent markets in Africa.

In Asia, a large and increasingly wealthy population with low levels of insurance and asset management coverage is creating a huge and fast-growing market for our health, protection and savings products. Asia is driving global growth, with average annual GDP growth in our Asia life markets of 10.4 per cent in the decade to 2017[8], compared with just 1.9 per cent for the rest of the world[8]. Furthermore, despite potential headwinds, between 2017 and 2023 Asia is expected to deliver 39 per cent of the world's GDP growth[8]. This is creating a rapidly growing middle class in the Asia region, which is expected to double by 2030 to reach 3.5 billion people[9]. At the same time, insurance penetration in Asia is just 2.7 per cent of GDP[10], compared with 7.2 per cent in the UK[10], leaving the region vastly under-insured with an estimated mortality protection gap of US$40 trillion[11] and a health and protection gap of US$1.8 trillion[12]. Similarly, mutual fund penetration in Asia is only 12 per cent[13], compared with 96 per cent in the US[13], whilst 65 per cent of wealth in Asia is held in cash[14]. With private financial wealth in the region growing by US$5 trillion per year[14], there is considerable latent demand for our savings solutions. These structural drivers of growth are expected to persist for many years to come and create a historic opportunity for us.

We are also developing our businesses in our newer markets in Africa, which is one of the world's most underserved life markets, and where the population is forecast to grow by a billion by 2045[1]. We are now operating in five countries in Africa - Ghana, Kenya, Nigeria, Uganda and Zambia which will increase further with the announced acquisition of a majority stake in Group Beneficial, and we are excited about the growing opportunities in this dynamic region.

We have a strong and growing opportunity in the US. About 40 million Americans are expected to reach retirement age over the next decade alone. At the same time, 72 per cent of American workers do not have access to a defined benefit retirement plan[15]. A study conducted by the Insured Retirement Institute and Jackson showed that 80 per cent of Americans think that social security will not provide enough income for retirement[16], and the same percentage are willing to pay more for guaranteed lifetime income[16]. This aligns with our retirement income products, which are designed to help customers avoid running out of money and provide them with a reliable cushion against volatile markets.

In the UK and Europe, notwithstanding the uncertainty related to the UK's intended exit from the European Union, a combination of global trends and competitive advantages is creating a powerful opportunity for M&GPrudential. Those approaching retirement have been looking for new ways to ensure a comfortable future, and since pensions freedoms were introduced in the UK in 2015 that demand has been increasing. At the same time, the total value of household cash deposits in the EU is estimated at €10 trillion[17], indicating the scale of the opportunity for asset management in the region. Private assets under management are expected nearly to double between 2017 and 2023[18]. M&GPrudential, which already has established international distribution, a clear focus on customer solutions and a broad-ranging investment capability, is transforming itself to meet this opportunity.

New and better ways to serve customers

We are continuing to improve the way we serve our customers in every part of the world in which we operate. We constantly update our products and our capabilities to ensure that we are fulfilling our purpose and maximising the effect of our strategy.

In Asia, we are continuing to develop and expand our products, distribution capabilities and footprint and to meet the evolving needs of our customers. During 2018, we broadened our product suite to include tailored propositions for the high-net-worth and corporate segments and developed new products for customers with specific needs, such as pre-existing medical conditions. Our distribution capabilities were enhanced by new digital technology and provide a seamless and differentiated customer experience from point of sale through to making a claim. At Eastspring, we also continued to roll out BlackRock's Aladdin system across our markets to improve efficiency. We broadened our reach through new partnerships with leading banks in several markets, including Thailand and the Philippines. Meanwhile, Eastspring consolidated its position as the leading retail asset manager in Asia (excluding Japan) by establishing an on-the-ground presence in China and Thailand. Early in 2019, we also renewed our successful regional strategic alliance with United Overseas Bank (UOB), one of our most successful distribution relationships in South-east Asia, until 2034 and added Vietnam and UOB's digital bank to an existing partnership presence in Singapore, Malaysia, Thailand and Indonesia.

We are also expanding our footprint in our Africa markets. In August 2018, we extended our long-term partnership with Standard Chartered Bank, which has been a huge success in Asia, to Ghana, and in November we signed a long-term exclusive partnership with Zambia National Commercial Bank Plc (Zanaco), Zambia's largest bank, to enable our market-leading products to be offered to more than a million new customers across the country.

In the US, we have a long and durable track record of delivering financial success for our consumers. We are offering new products for fee-based advisers and have launched new versions of our fee-based variable annuities. We are changing the narrative around retirement and lifetime income, demonstrating the value proposition of our products to regulators, investors, policyholders and influential industry figures. In September, we announced our collaboration with the Envestnet Insurance Exchange, to offer our products on its platform. In October, we announced a key distribution partnership with State Farm, further strengthening our market-leading distribution footprint. Early in 2019, we partnered with DPL Financial Partners to provide our protected lifetime solutions to independent registered investment advisers (RIA), providing access to new opportunities in the independent RIA channel.

In the UK and Europe, as M&GPrudential prepares for the demerger, we have been continuing to transform what we do for our customers and how we do it. Our PruFund offering continues to impress customers with its combination of clarity, capital growth and lower volatility. We are investing to transform the experience of our fast-growing digital platform, launched in 2016, to ensure it offers a comprehensive range of solutions for customers. In our investment management business, we continue to develop our private asset capacity and now have £59 billion of private assets under management, making us one of the largest private credit investors in the world, and we are looking to expand our differentiated capabilities across geographies and asset classes. In 2018, M&GPrudential also signed a new partnership with Tata Consultancy Services (TCS), a global leader in IT, business process and digital services, to enhance service for our UK and Europe savings and retirement customers.

Throughout our businesses, we are continuing to develop our digital capabilities. In Asia, such initiatives are enabling us to provide valuable and innovative services to our customers. In August, we announced our exclusive partnership agreement with the UK-based healthcare technology and services company Babylon Health. Through the deployment of cutting-edge artificial intelligence technology, this partnership will offer customers, in up to 12 of our markets in Asia, access to a comprehensive set of digital health tools, complementing Prudential Corporation Asia's existing suite of world-class protection products and strengthening our digital future. Similarly, at Eastspring, our robo-advice platform in Taiwan, in partnership with Alkanza, helps our clients meet their savings goals. We recognise that technology continually evolves and we embrace the possibilities that lie ahead. Our sponsorship of Singapore's FinTech Festival, which in 2018 had more than 400 exhibitors from 35 countries, showcasing the very latest in digital innovation, is testament to this and presents all kinds of partnership possibilities. Indeed, our Singapore business has since partnered with three of the propositions showcased at the event.

Our leadership

In July 2018, we announced that Anne Richards was resigning as Chief Executive of M&G and from the Group's Board. In October 2018, we announced that Barry Stowe had decided to retire as Chairman and Chief Executive Officer of Jackson and as an Executive Director of the Group. Barry has been succeeded at Jackson by Michael Falcon. Formerly CEO of Asia Pacific for JP Morgan Asset Management, Michael has deep expertise and an impressive track record in the industry and is well placed to lead the next phase of our development in North America. We continue to invest in the right people at all levels across the Group.

Delivering value into the future

Our clear strategy, discipline and improving capabilities have enabled us to deliver a broad-based financial performance in 2018, based on a close focus on our core purpose of helping people to de-risk their lives and deal with their biggest financial concerns. In Asia we continue to see a strong runway for the insurance and asset management industries, and our presence, scale and distribution reach position us well to participate strongly in this growth. In the US, we continue to provide Americans with the retirement strategies they need, and we are confident that this will enable us to capture additional growth into the future. In the UK and

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Europe, we will continue to improve service levels and launch new offerings, and we are making good progress towards the intended demerger of M&GPrudential from the Group, which will result in two distinct businesses that are able to focus more clearly on the opportunities open to us. We have an established track record of delivering important benefits to our customers and profitable growth to our shareholders. We are confident that, post demerger as independent companies, both Prudential plc and M&GPrudential will be positioned to continue to do well in the future.

Notes

1. United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision. American population reaching retirement age over the next decade is based on 2019 population, aged 55 to 64.
2. Year-on-year percentage increases are stated on a constant exchange rate basis unless otherwise stated.
3. Adjusted IFRS operating profit based on longer-term investment returns 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 consolidated financial statements.
4. Growth rate on an actual exchange rate basis.
5. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.
6. Estimated before allowing for second interim ordinary dividend.
7. Represents M&GPrudential asset management external funds under management and internal funds included on the M&GPrudential long-term insurance business balance sheet.
8. IMF. 2017 GDP at January 2019 current prices. Asia represents Prudential Corporation Asia's life business footprint.
9. Brookings Institution. Global Economy & Development Working Paper 100. February 2017. 'Asia' represents Asia Pacific.
10. Insurance penetration   Swiss Re Sigma No 3/2018. Insurance penetration calculated as premiums as a percentage of GDP. Asia penetration calculated on a weighted population basis.
11. Swiss Re Mortality Protection Gap Asia Pacific 2018. Represents Prudential Corporation Asia's life business footprint, and use per capita income of working population as the base unit to calculate the size of the gap.
12. Swiss Re Asia's health protection gap: insights for building greater resilience. October 2018. Represents China, India, Japan, Korea, Indonesia, Malaysia, Taiwan, Vietnam, the Philippines, Singapore, Hong Kong and Thailand.
13. Investment Company Institute, industry associations and Lipper.
14.

BCG Global Wealth 2017. Navigating the New Client Landscape.

15.

U.S. Bureau of Labor Statistics, National Compensation. Survey: Employee Benefits in the United States, March 2017. Workers defined as those employed in private industry and state and local government.

16.

The Language of Retirement 2017 study conducted on behalf of the Insured Retirement Institute and Jackson.

17.

Eurostat: Household deposit data.

18.

Preqin Future of Alternatives Report, October 2018.

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OUR BUSINESS SEGMENTS

The Prudential Group is structured around three main business units: Prudential Corporation Asia, the North American Business Unit and M&GPrudential in UK and Europe. In addition, in recent years, the Group has expanded into Africa. These business units derive revenue from both long-term insurance and asset management activities. These are supported by central functions which are responsible for Prudential strategy, cash and capital management, leadership development and succession, reputation management and other core group functions.

In 2018, the Group announced its intention to demerge its UK and Europe businesses from Prudential plc, to form two separately listed companies. Please refer to the 'UK and Europe' section for further details.

Asia

Introduction

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

Eastspring Investments, Prudential's asset management business in Asia, manages investments for Prudential's Asia and UK life companies and also has a broad base of third-party retail and institutional clients. Eastspring has a number of advantages and is well placed for the anticipated growth in Asia's retail mutual fund market. It has one of the largest footprints in Asia, being operational in 11 major markets and distribution offices in US and Europe. It has a well-diversified customer base, comprising Prudential's internal life funds, and a number of institutional clients, including sovereign wealth funds and retail customers. Assets managed are well diversified between fixed income and equities and also include infrastructure funds.

As at 31 December 2018, Prudential Corporation Asia had:

- 15 million life insurance customers with life and fund management operations in 14 markets;
- Access to more than 14,000 bank branches across Asia with relationships including Standard Chartered Bank (SCB), United Overseas Bank Limited (UOB), ICICI Bank in India, CITIC in China and Thanachart in Thailand;
- Over 600,000 agents across the region;
- Consistently high brand recognition, with multiple awards received for its customer service; and
- Top three positions in eight out of our 12 insurance markets.

Our business

It is 95 years since we established our first operations in Asia. Our long heritage and strong brand awareness form the foundations of our business and today our footprint spans 14 markets and encompasses 3.6 billion people. We have a top three position in eight out of our 12 insurance markets[3] and Eastspring, our asset management business, remains the largest pan-regional retail asset manager in Asia, excluding Japan. In addition, Eastspring retained the prestigious 'Best Asia Fund House' accolade in 2018, a feat that has now been achieved in three of the past four years.

We believe our commitment to customers on 'listening, understanding, delivering' is a key differentiator. To fulfil this, we adopt a multi-channel strategy with over 600,000 agents, over 300 distribution partners and an increasing online offering, enabling us to serve our customers' needs in their preferred manner. We have a proven ability to attract, develop and retain a talented and diverse workforce, employing over 13,000 people with more than 40 separate nationalities and wide-ranging industry backgrounds. This enables us to remain at the forefront of product development, create innovative services for our customers and embed digital technology to drive efficiency.

We are also able to translate these hallmarks of our business into financial success, with our strong performance in 2018 building upon our existing excellent track record. Our gross premium earned grew[4] by

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9 per cent[1] to £16.5 billion, and renewal premiums[5] grew by 16 per cent[1]. This helped deliver a 14 per cent[1] increase in adjusted IFRS operating profit based on longer-term investment returns[6] to £2.2 billion and grow our total assets by 11 per cent[7] to £94.2 billion. At Eastspring, we managed funds totalling £151 billion at the end of 2018, invested in over 1,600 funds.

Market opportunity

In Asia, we provide insurance and asset management solutions that enable customers of all ages to address their health, protection and savings needs. Demand for our products is underpinned by low levels of existing coverage and is further supported by economic and demographic tailwinds that look set to persist over the coming decades.

Today, consumers in Asia are both under-insured and under-saved during their working lives, which leaves them inadequately prepared for retirement. This is evident from the significant gap in life insurance penetration rates compared with developed markets. Furthermore, the limited welfare social safety net in many of our markets means that out-of-pocket healthcare spend by people in Asia is three to four times the proportion seen in the US and UK. Collectively, these dynamics resulted in an estimated health protection gap of US$1.8 trillion in 2017 across the Asia region[8].

The economic growth potential of the region is widely recognised and is expected to translate into rising levels of affluence, with 88 per cent of the next billion entrants into the middle class predicted to be based in Asia[9]. Entering the middle class is typically the trigger for individuals to protect their health and that of their families, while also seeking to manage and grow their wealth. Indeed, total annual expenditure by Asia's middle class is forecast to reach US$37 trillion in 2030[9], more than double the current amount.

Asia's economies are also benefiting from a demographic dividend with moderating fertility rates and improving life expectancy. In youthful markets, such as Indonesia, this is creating a surge in the working age population and with that a continued source of demand for our products. Across Asia the working age population is forecast to grow by almost one million people per month between now and 2030 to 2.5 billion people[10]. Meanwhile, the number of those aged over 65 is projected to almost treble by 2050 to 700 million[10]. This is expected to create demand for new solutions in markets with ageing populations, such as Hong Kong and China, as individuals look to maintain their standard of living during retirement.

Whilst these trends provide an attractive backdrop, we need to remain diligent and focused in our execution as a wide range of external developments can affect our business. The escalating trade related tensions between the US and China contributed to increased equity market volatility in the second half of 2018. The landmark election result in Malaysia heralded the first change in governing party since independence in 1957 and we have been actively discussing how we support the new leadership in their desire to provide greater insurance access to the Malaysian population. In China, there was a step forwards in easing foreign investment in the insurance sector, with caps on foreign ownership expected to be lifted by 2021. Alongside these developments, regulators across the region are seeking to reward disciplined risk-management practices by strengthening consumer protection and migrating to risk-based solvency frameworks.

We are steadfast in our conviction that the structural drivers of consumer demand in this region are of greater significance to our business than short-term market or regulatory driven events. We also recognise that the insurance industry is not immune to the pervasive impact of technology and the way this is shaping our customers' expectations and behaviours with regards to accessibility, service and overall experience. These perspectives are instrumental in guiding the decisions we take to position our business for future success.

Strategic priorities

Our business achieves high risk-adjusted returns by maintaining a disciplined focus on value. Two key distinguishing features of our sales mix are the contribution from health and protection products and the high proportion of regular premiums. We favour this mix because it provides our shareholders with a higher and more stable return across market cycles. Our success in health and protection is underpinned by our comprehensive underwriting processes, extensive experience and technical capabilities of our in-house professionals. Meanwhile, the high proportion of regular premiums ensures we collect a steady stream of revenues across market cycles.

This focus on value is supported by four strategic priorities that we believe align with the evolving sources of demand across the region and hence will position our business for continued future growth. We seek to *enhance the core* of our existing business by improving our customers' experience. Significantly, we have extended our exclusive partnership with UOB until the end of 2034 and, due to its success to date, agreed to expand its scope to include Vietnam and UOB's digital bank. We also continued to expand and diversify our distribution reach with nine new bank partnerships across six of our markets being successfully activated during 2018, including Siam Commercial Bank in Thailand and O-Bank, the first digital bank in Taiwan. The success of these partnerships is underpinned by the quality and competitiveness of our products, the additional value-added services we offer to customers and the digital tools and training we provide to sales teams.

We simplify the process of purchasing a policy by embracing the latest technology and embedding this within proprietary tools used by our agents and bank partners. For example, over 70 per cent of all new business was submitted through e-point-of-sale technology. Our smart underwriting tool, which is now used in 59 per cent of all sales, provides dynamic underwriting that streamlines the application process, while also communicating instant underwriting decisions to customers.

We also use digital technology in servicing policies, both to improve the efficiency of our business and to enhance customer satisfaction. In Hong Kong we developed the 'Hospital to Prudential' portal to redefine the way our customers and medical professionals manage hospital claims, reducing the time required to submit a claim to just three minutes. Meanwhile, in China we have extended our award-winning WeChat self-service platform to include 90 per cent of all policy administration actions. Similarly, in Thailand we created a new customer services touchpoint through PruConnect, which enables customers to quickly access key information such as policy information, premium certificates and nearby network hospitals.

Secondly, we want to *create 'best-in-class' health capabilities*. Our strategy is supported by distinctive value-added services, such as the exclusive multi-year partnership we signed with Babylon, a UK-based healthcare and technology services company. This partnership will provide personal health assessments and treatment information, powered by artificial intelligence, which will transform health provision for our customers. This will greatly enhance our customers' access to healthcare, particularly for those in remote locations, whilst empowering them to proactively manage their health in a flexible and cost-efficient manner.

Thirdly, we plan to *accelerate Eastspring* by expanding its existing investment offering and enhancing its distribution capabilities. We have continued to strengthen our in-house investment teams, which helped us launch 51 new products in 2018. In September, we also entered Thailand, the largest mutual fund market in the Association of Southeast Asian Nations (ASEAN)[12], with the acquisition of TMB Asset Management. Our on-the-ground team recently launched an Asia Pacific Property Flexible Fund that obtained inflows totalling US$91 million during the week-long initial public offering period.

Finally, we intend to expand our *presence in China* across both the insurance and asset management sectors. We recently established a new branch in Hunan and received regulatory approval to undertake preparatory work to establish a new branch in Shaanxi, our nineteenth and twentieth provinces, respectively, offering access to over 100 million new people. This geographic expansion is supported by the diligent growth in our agency force, which grew by 7 per cent in 2018 to 48,000 agents. We also formed a two-year research partnership with the Development Research Centre of the State Council focused on the development of a sustainable pension system, which is testament to our aspirations in this market and our differentiated capabilities. Another major milestone in China was the opening of Eastspring's wholly foreign-owned enterprise in Shanghai. This enables us to manage onshore investments for high-net-worth individuals and institutional investors in China, complementing our existing asset management joint venture with CITIC. Our first private fund has a Chinese equities mandate and is expected to launch in April 2019, with further investment strategies planned to follow in due course.

Customers

Our strong reputation and success to date have been built on a foundation of excellent customer service. During 2018, we added a further 1.4 million new life customers[2], bringing the total to over 15 million life customers. Our strong retention ratio, which remained in excess of 90 per cent, and the consistently high proportion of repeat sales, demonstrate the regard and trust our customers have in our business. These dynamics mean that we have 24 million in-force policies in total, with each of our policyholders holding 1.6 policies on average. In addition, our focus on health and protection business is reflected in a 7 per cent increase in sum-at-risk per policy, which is a leading measure of insurance coverage. Funds managed by Eastspring grew by 6 per cent to £151 billion at the end of 2018, with 10 per cent growth amongst third-party retail clients.

We maintain this advantage by constantly striving to improve the experience of our customers, with whom we have over two million interactions every month, including over 300,000 calls. Our customers typically need us most when they want to submit a claim as this can signify the death or illness of a family member. Consequently, we strive to provide a frictionless claims process at this sensitive time. To facilitate this, our new

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Jet claims tool, which is currently being used in Hong Kong and Indonesia, can automatically review, assess and pay a claim on the same day. We now have e-claims capability in six of our businesses and have already attained submission rates of almost 40 per cent. We also leverage technology in our more regular dealings with customers. For example, our new Virtual Assistant in Hong Kong, which builds upon the success of our askPRU chatbot that was launched in Singapore in 2017 and reduced call centre volumes by 40 per cent, already has answers to many frequently asked questions from agents and policyholders.

At Eastspring we use digital tools to help our retail clients set and achieve their savings goals. Our partnership with Alkanza has enabled us to build a robo-advisory platform in Taiwan that can suggest portfolio rebalancing if performance is off track and has the functionality to show the impact of changes in parameters, such as retirement age and contribution amount.

Products

We offer our customers a broad range of health, protection and savings solutions that are tailored to local market requirements and individual needs. Key to our ongoing success is our focus on upgrading our product suite to add innovative new features. For example, in Hong Kong we launched a new critical illness product with extended protection for cancer, heart attacks and strokes, and three common causes of death. Similarly, we enhanced our protection product for mothers and unborn children in Malaysia, PRUmy child, by expanding the range of pregnancy complications included and extending the coverage period for congenital illnesses. We are also actively developing products to meet the upcoming needs of Asia's ageing populations and were amongst the first group of insurers to be granted approval to offer a tax-deferred pension product in China.

In addition, we develop products with specialist characteristics that broaden our offering and appeal. We have been proponents of products that comply with the requirements of Islamic law for many years. Indeed, we offer such products by default, and sales of our Syariah products in Indonesia grew by 17 per cent in 2018 to over £50 million. This positions us as market leaders in Indonesia's Syariah market, in addition to Malaysia's Takaful market, with market shares of approximately 30 per cent in both cases. We have also launched PRUvital cover in Singapore, a first-in-the-market protection plan for customers with four types of common pre-existing chronic medical condition that previously could act as barriers in obtaining insurance coverage.

Historically our products were targeted at the mass and affluent market segments. We are purposefully developing new products to meet the needs of other segments. In Singapore we recently launched Opus, a proposition specifically tailored for high-net-worth customers. This brings a differentiated experience for our customers and includes a dedicated service team, wealth planners and external experts covering trust and legal matters. We also launched PRUworks, our new insurance proposition for the corporate segment to target small and medium enterprises. Our PRUworks platform is an all-inclusive platform that comes with a digitally enabled HR solution for business owners and their employees, which provides access to employee benefits and services alongside additional services such as lifestyle programmes.

New Business Premiums

In 2018, total sales of insurance products are down by 3 per cent from 2017 to £5,829 million (2017: £6,006 million; 2016: £5,948 million, both including Korea). Of this amount, regular premium insurance sales decreased by 4 per cent to £3,513 million (2017: £3,650 million; 2016: £3,453 million) and single premium insurance sales fell by 2 per cent from 2017 to £2,316 million (2017: £2,356 million; 2016: £2,495 million).

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The following table shows Prudential's Asia life insurance new business premiums by business unit for the periods indicated.

	Year ended 31 December £m (AER)		
	2018	**2017**	**2016**
Single premiums			
Hong Kong	**343**	582	1,140
Indonesia	**205**	288	236
Malaysia	**84**	73	110
Philippines	**43**	62	91
Singapore	**930**	859	523
Thailand	**217**	139	80
Vietnam	**20**	8	6
South East Asia operations including Hong Kong	**1,842**	2,011	2,186
China (Prudential's 50% proportionate share in joint venture)	**103**	179	124
Taiwan	**292**	46	36
India (Prudential's 26% proportionate share in associate)	**79**	63	51
Total excluding Korea	**2,316**	2,299	2,397
Korea*	**-**	57	98
Total including Korea	**2,316**	2,356	2,495
Regular premiums			
Cambodia	**20**	16	14
Hong Kong	**1,663**	1,667	1,798
Indonesia	**215**	268	255
Malaysia	**243**	271	233
Philippines	**83**	71	61
Singapore	**369**	361	299
Thailand	**95**	70	81
Vietnam	**144**	133	115
South East Asia operations including Hong Kong	**2,832**	2,857	2,856
China (Prudential's 50% proportionate share in joint venture)	**292**	276	187
Taiwan	**182**	208	146
India (Prudential's 26% proportionate share in associate)	**207**	234	170
Total excluding Korea	**3,513**	3,575	3,359
Korea*	**-**	75	94
Total including Korea	**3,513**	3,650	3,453
Total new business premiums			

Total excluding Korea	**5,829**	5,874	5,756
Korea*	**-**	132	192
Total including Korea	**5,829**	6,006	5,948

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

	At 31 December £bn	
	2018	**2017**
Internal funds under management	**90.2**	83.0
External funds under management	**61.1**	55.9
Total	**151.3**	138.9

* The new business premiums from the Group's Korea life business are shown separately in the table above as it was sold in May 2017.

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Distribution

Our diversified mix of tied agents and bank partners creates one of the strongest distribution networks across the region with non-traditional partnerships further broadening our reach. Our experience shows customers have an overarching preference for face-to-face advice from a trusted financial adviser while also increasingly demanding the flexibility to conduct basic research and fact-finding themselves digitally. Thus, whilst our tied agents and in-branch bank staff remain our primary distribution channels, customers are now more actively engaging with us through our online platforms.

Prudential has over 600,000 licenced tied agents across our 12 life markets in Asia. This proprietary distribution channel is a core component of our success. The value provided by our tied agents makes it paramount for us to continue expanding their reach and enhancing their capabilities. We place great emphasis on the professionalism and productivity of our agency force, and facilitate this by continually providing new and upgraded tools. This creates a culture whereby our agents aspire to attain membership of the 'Million Dollar Round Table', an industry-recognised indicator of quality. We currently have over 7,000 such qualifiers, which would represent annual growth in members of approximately 20 per cent[13] and reflects our focus on the recruitment, training and productivity of our agents, the emphasis on which varies by market. In our younger markets we are typically still accelerating recruitment. For example, we added over 1,100 new agents per month in the Philippines on average during 2018, which was more than 40 per cent higher than in 2017, and helped expand our agency force to around 28,000 agents. As markets mature the emphasis starts to shift towards the other factors. We have designed an entrepreneur development programme to fast-track our successful professional agents into leaders, which in turn supports our activation of new recruits. This programme has already been launched in China, where the number of active agents grew by 12 per cent in 2018.

We have also started collaborating with non-traditional partners, including DirectAsia, Hiscox's online property and casualty business in Singapore, and Eureka, a data management and analytics platform based in Indonesia. These mutually beneficial partnerships will enable us to reach new customers and create unique opportunities for our existing ones.

Business outlook

We continue to see a strong runway for the insurance and asset management industries in Asia. We recently conducted a strategic assessment, which re-affirmed the strengths of our business, established the potential future size of our markets and has informed our future investment pathway.

The review demonstrated that we are well positioned in the traditional life insurance segment, with a market share of approximately 25 per cent[14]. We forecast that this market has the potential to continue growing at a double-digit rate over the coming five years, due to the underlying structural drivers of demand in the region. Our presence, scale and broad product and distribution reach position us well to participate strongly in this expected growth.

We also anticipate strong growth in the medical reimbursement segment in our current markets, which we believe will more than double in the next five years due to increasing consumer demand. We have estimated that our share of the value pool in this segment is currently 9 per cent, which gives us significant scope to expand. This ambition is reflected in our strategic priorities with recent investments, such as Babylon, transforming our offering.

Our market-leading position in retail fund management reflects our region-wide presence and strong operating credentials. This positions us well for the future growth in the market that is expected from new wealth creation and the shift we envisage from deposits to riskier investments. We believe these factors make double-digit growth viable in India, where we are market leaders, alongside other key markets such as China and Thailand, where we have taken action to strengthen our position.

Notes

1. Growth rate on a constant exchange rate basis.
2. Excluding India.
3. Based on full year 2018 or the latest information available. Sources include formal (eg competitors results release, local regulators and insurance association) and informal (industry exchange) market share data. Ranking based on new business (APE sales, weighted full year premium or full year premium depending on availability of data). APE is defined under the section 'EEV Basis, New Business Results and Free Surplus

Generation' in this document.

4.
IFRS gross premiums earned for Asia segment.

5.
Includes renewal premiums from joint ventures. See note III of the additional unaudited financial information for reconciliation to IFRS balances.

6.
Adjusted IFRS operating profit based on longer-term investment returns. See note B1 of the IFRS financial statements for reconciliation to IFRS profit.

7.
Growth rate on an actual exchange rate basis.

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8. Swiss Re Institute: The health protection gap in Asia, October 2018. Average gap per household is calculated as 'total health protection gap divided by the estimated number of households hospitalised under the mentioned gap range'. Report excludes Cambodia and Laos.
9. Brookings Institution. Global Economy & Development Working Paper 100. February 2017. 'Asia' represents Asia Pacific.
10. United Nations, Department of Economics and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision.
11. Working age population: 15 to 64 years.
12. ©Copyright 2018 Strategic Insight, an Asset International Company and when referenced or sourced Morningstar Inc., Standard & Poor's Inc., and Lipper Inc. All rights reserved. The information, data, analyses and opinions contained herein (a) include confidential and proprietary information of the aforementioned companies, (b) may not be copied or redistributed for any purpose, (c) are provided solely for information purposes, and (d) are not warranted or represented to be correct, complete, accurate, or timely.
13. Based on 100 per cent conversion of qualifiers into members.
14. Proprietary research/Bain Analysis (2018) covering the following markets: Hong Kong; Singapore; Indonesia; Malaysia; China; and India, using sales data provided by insurance regulators, insurance associations and industry expert surveys in these markets.

United States

Introduction

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

As at 31 December 2018, in the US, Jackson:

- Was the 15th largest life insurance company in terms of general account assets[5];
- Had 18 per cent market share of US variable annuities[1] and had £129 billion (US$ 163 billion) of separate account assets; and
- Has been recognised for customer service performance with the "Contact Center World Class CX Certification' and 'Highest Customer Service for the Financial Industry' awards by The Service Quality Measurement Group, Inc.

The US operations also include PPM Holdings, Inc. (PPM), Prudential's US internal and institutional investment management operation. As at 31 December 2018, Prudential's US operations had more than 4 million policies and contracts in force and PPM managed approximately £92.2 billion of assets. In 2018, new business premiums totalled £15,423 million.

Market overview

The US is the world's largest retirement savings market with approximately 40 million Americans reaching retirement age over the next decade. This transition will trigger the need for an unprecedented shift of trillions of dollars from savings accumulation to retirement income generation.

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

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

In response to this demand and the ongoing shift to fee-based solutions, Jackson has positioned itself with product innovation and distribution strategies to further enhance our market-leading VA position in the brokerage market and grow in the advisory retirement solutions market.

Customers and products

Through its distribution partners, Jackson provides products that offer Americans the retirement strategies they need, including variable, fixed, and fixed index annuities. Each of these products offer a unique range of features tailored to meet the individual needs of the retiree:

Variable annuity: A Jackson variable annuity, with investment freedom, represents an attractive option for retirees, providing both access to equity market appreciation and guaranteed lifetime income as an add on benefit.

Fixed index annuity: A Jackson fixed index annuity is a guaranteed product with limited market exposure but no direct equity ownership. It is designed to build wealth through a combination of a base crediting rate that is generally lower than a traditional fixed annuity crediting rate, but with the potential for additional upside, based upon the performance of the linked index.

Fixed annuity: A Jackson fixed annuity is a guaranteed product designed to build wealth without market exposure, through a crediting rate that is likely to be superior to interest rates offered from banks or money market funds.

These products also offer tax deferral, allowing interest and earnings to grow tax-free until withdrawals are made.

Jackson has a proven track record in this market with its market-leading flagship product[1], Perspective II. Jackson's success has been built on its quick-to-market product innovation, as demonstrated by the development and launch of Elite Access, our investment-only variable annuity. Further demonstrating Jackson's flexibility and manufacturing capabilities, and in response to the trend in financial services toward fee-based solutions, Jackson has launched Perspective Advisory II and Elite Access Advisory II to serve advisers and distributors with a preference for advisory products.

In March 2018, Jackson launched MarketProtector and MarketProtector Advisory, two new fixed annuities with index-linked interest. These products provide consumers with the sought-after combination of tax-deferred investment growth, protection from market risk and the flexibility to adapt to changing needs in retirement. Both products offer an add-on living benefit that allows customers to safeguard their financial futures with income for life.

Also, in 2018, Jackson took a lead role in bringing together 24 of America's financial services organisations to launch the Alliance for Lifetime Income (Alliance). The Alliance was launched to educate Americans on the risk of outliving their income, so they can enjoy their years in retirement. The Alliance's nationwide, multi-year, integrated educational campaign is designed to raise awareness and motivate consumers and financial advisers to discuss the need for protected lifetime income in retirement, which can be achieved with the use of annuity products such as those provided by Jackson.

Additional information on products

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

	Year Ended 31 December £m (AER)		
By Product	**2018**	**2017**	**2016**
Annuities			
Fixed annuities			
Fixed interest rate	**316**	434	533
Fixed index	**251**	295	508
Immediate	**24**	20	22
Variable annuities	**10,810**	11,536	10,653
Elite Access (Variable annuities)	**1,681**	2,013	2,056
Total	**13,082**	14,298	13,772
Institutional products			
GICs, funding agreements and Federal Home Loan Bank of Indianapolis (FHLBI) funding agreements	**2,341**	2,324	1,836
Total	**15,423**	16,622	15,608

By Distribution Channel

Independent broker dealer	**8,988**	9,637	8,809
Bank	**1,705**	1,948	2,137
Regional broker dealer	**1,986**	2,228	2,199
Independent insurance agents	**403**	485	627
Institutional products	**2,341**	2,324	1,836
Total	**15,423**	16,622	15,608

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Of the total new business premiums of £15,423 million in 2018 (2017: £16,622 million; 2016: £15,608 million), £13,082 million (2017: £14,298 million; 2016: £13,772 million) were annuity premiums, and £2,341 million (2017: £2,324 million; 2016: £1,836 million) were institutional product premiums. All of these premiums were single premiums.

Annuities

Fixed annuities

Fixed interest rate annuities

In 2018, fixed interest rate annuities account for 2 per cent (2017: 3 per cent) of total new business premiums and 7 per cent (2017: 7 per cent) of policy and contract liabilities of the US operations. Fixed interest rate annuities are primarily deferred annuity products that are used for asset accumulation in retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The contract holder of a fixed interest rate annuity pays Jackson a premium, which is credited to their account. Periodically, interest is credited to the contract holder's account and in some cases administrative charges are deducted from the contract holder's account. Jackson makes benefit payments at a future date as specified in the contract based on the value of the contract holder's account at that date. On more than 94 per cent (2017: 94 per cent) of in-force business, Jackson may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, Jackson either pays the contract holder the account value or a series of payments in the form of an immediate annuity product.

At 31 December 2018, Jackson had fixed interest rate annuities with account values totalling £12.6 billion (US$16.1 billion) (2017: £12.6 billion (US$17.0 billion)) with minimum guaranteed rates ranging from 1.0 per cent to 5.5 per cent for which the average guaranteed rate was 2.91 per cent (2017: 1.0 per cent to 5.5 per cent and a 2.93 per cent average guaranteed rate).

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

Approximately 64 per cent (2017: 60 per cent) of the fixed interest rate annuities Jackson wrote in 2018 provide for a market value adjustment that could be positive or negative on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment. While the MVA feature minimizes the surrender risk associated with certain fixed interest rate annuities, Jackson still bears a portion of the surrender risk on policies without this feature, and the investment risk on all fixed interest rate annuities.

Fixed index annuities

Fixed index annuities accounted for 2 per cent (2017: 2 per cent) of total new business premiums in 2018 and 5 per cent (2017: 5 per cent) of Jackson's policy and contract liabilities. Fixed index annuities vary in structure, but generally are deferred annuities that enable the contract holder to obtain a portion of an equity-linked return (based on participation rates and caps) and provide a guaranteed minimum return. These guaranteed minimum rates are generally set at 1.0 per cent to 3.0 per cent on index funds. At 31 December 2018, Jackson had fixed index annuities allocated to index funds with account values totalling £6.0 billion (US$7.7 billion) (31 December 2017: £6.3 billion (US$8.6 billion)) with minimum guaranteed rates on index accounts ranging from 1.0 per cent to 3.0 per cent for which the average guaranteed rate is 1.77 per cent (2017: 1.0 per cent to 3.0 per cent and a 1.77 per cent average guaranteed rate). Jackson also offers fixed interest accounts on some fixed index annuity products. At 31 December 2018, fixed interest accounts on fixed index annuities totalled £2.7 billion (US$3.5 billion) (2017: £2.5 billion (US$3.4 billion)) with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 2.57 per cent average guaranteed rate (2017: 1.0 per cent to 3.0 per cent and a 2.58 per cent average guaranteed rate).

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

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

Group pay-out annuities

Group pay-out annuities consist of a block of defined benefit annuity plans assumed from John Hancock Life Insurance Company (John Hancock USA) in 2018 through a reinsurance agreement. A single premium payment from an employer (contract holder) funds the pension benefits for its employees (participants). The contracts are tailored to meet the requirements of the specific pension plan being covered. This is a closed block of business from two standpoints: (1) John Hancock USA is no longer selling new contracts and (2) contract holders (companies) are no longer adding additional participants to these defined benefit pension plans. The majority of participants are in the pay-out phase, but there are some participants in the deferral phase.

The contracts provide annuity payments that meet the requirements of the specific pension plan being covered. In some cases, the contracts have pre-retirement death and/or withdrawal benefits, pre-retirement surviving spouse benefits, and/or subsidised early retirement benefits. Given that this reinsurance agreement is a one-off transaction, the premium received has not been included in the new business premiums table above.

Variable annuities

In 2018, variable annuities accounted for 81 per cent (2017: 81 per cent) of total new business premiums and 75 per cent (2017: 77 per cent) of Jackson's policy and contract liabilities. Variable annuities are deferred annuities that have the same tax advantages and payout options as fixed interest rate and fixed index annuities. They are also used for asset accumulation in retirement planning and to provide income in retirement.

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

At 31 December 2018, Jackson had variable annuity funds in fixed accounts totalling £6.4 billion (US$8.1 billion) (2017: £5.9 billion (US$8.0 billion)) with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and an average guaranteed rate of 1.70 per cent (2017: 1.0 per cent to 3.0 per cent and a 1.68 per cent average guaranteed rate).

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

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

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

Aggregate distribution of account values

As described above, at 31 December 2018, Jackson had fixed annuities (fixed interest rate and fixed index) and variable annuities fixed options with account values totalling £27.7 billion (2017: £27.3 billion) in account value with minimum guaranteed rates. The table below shows the distribution of these account values within the range of minimum guaranteed interest rates at the dates indicated.

	Account value at 31 December £m	
Minimum guaranteed interest rates - annuities	**2018**	**2017**
1.0%	**7,584**	6,887
> 1.0% - 2.0%	**6,789**	7,385
> 2.0% - 3.0%	**10,075**	9,799
> 3.0% - 4.0%	**1,274**	1,272
> 4.0% - 5.0%	**1,794**	1,744
> 5.0% - 5.5%	**225**	220
Total	**27,741**	27,307

Life insurance

Background

Jackson discontinued new sales of life insurance products in 2012. The discontinued life insurance products accounted for 9 per cent (2017: 9 per cent) of Jackson's policy and contract liabilities in 2018. Life products include term life and interest sensitive life (universal life and variable universal life.) Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a type of life insurance policy that combines death benefit protection with the ability for the contract holder account to be invested in separate account funds. Jackson's life insurance book has delivered consistent profitability, driven primarily by positive mortality and persistency margins. For certain fixed universal life plans, additional provisions are held to reflect the existence of guarantees offered in the past that are no longer supported by earnings on the existing asset portfolio, or for situations where future mortality charges are not expected to be sufficient to provide for future mortality costs.

Aggregate distribution of account values

Excluding the business formerly of the REALIC operations acquired in 2012 that is subject to the retrocession treaties, at 31 December 2018, Jackson had interest-sensitive life business in force with total account values of £6.4 billion (US$8.2 billion) (2017: £6.3 billion (US$8.5 billion)), with minimum guaranteed interest rates ranging from 2.5 per cent to 6.0 per cent with a 4.67 per cent average guaranteed rate (2017: 2.5 per cent to 6.0 per cent with a 4.67 per cent average guaranteed rate). The table below shows the distribution of the

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interest-sensitive life business' account values within this range of minimum guaranteed interest rates at the dates indicated.

Minimum guaranteed interest rates - life insurance	Account value at 31 December £m	
	2018	**2017**
> 2.0% - 3.0%	**229**	221
> 3.0% - 4.0%	**2,394**	2,341
> 4.0% - 5.0%	**2,106**	2,059
> 5.0% - 6.0%	**1,703**	1,651
Total	**6,432**	6,272

Institutional products

Institutional products consist of traditional guaranteed investment contracts (GICs), funding agreements (including agreements issued in conjunction with Jackson's participation in the US Federal Home Loan Bank of Indianapolis (FHLBI) programme) and Medium-Term Note funding agreements. In 2018, institutional products accounted for 15 per cent (2017: 14 per cent) of total new business premiums and 1 per cent (2017: 1 per cent) of Jackson's policy and contract liabilities. The GICs are marketed by Jackson's institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its programme. Jackson makes its profit on the spread between the yield on its investments and the interest rate credited to contract holders.

Traditional guaranteed investment contracts

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

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

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

Funding agreements

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

The funding agreements may permit termination by the contract holder on seven to 90 days' notice. In 2018 and 2017, there were no funding agreements terminable by the contract holder with less than 90 days' notice.

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

Medium Term Note funding agreements

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

Distribution

Jackson distributes products in all 50 states of the US and in the District of Columbia. Operations in the state of New York are conducted through a New York subsidiary. Jackson markets its retail products primarily through advice-based distribution channels, including independent agents, independent broker-dealer firms, regional broker-dealers, wirehouses and banks. For variable annuity sales, Jackson is the leader in the independent broker-dealer, bank and wirehouse channels[2] and fourth in regional firms[2].

Jackson's distribution strength also sets us apart from our competitors. Our wholesaling force is the largest[3] in the variable annuity industry and is instrumental in supporting the independent advisers who help the growing pool of American retirees develop effective retirement strategies. Our wholesalers provide extensive training to thousands of advisers about the range of products and the investment strategies that are available to support their clients. Based on the latest available data, Jackson is the most productive variable annuity wholesale distribution force in the US[3].

In October 2018, Jackson announced a new distribution relationship with State Farm®. In the second half of 2019, authorised State Farm agents will begin offering a select group of Jackson's variable annuity and fixed index annuity products. While Jackson currently maintains one of the largest sales teams in the industry, this distribution relationship will add significant distribution access through State Farm's growing network of qualified producers.

In February 2019, Jackson partnered with DPL Financial Partners (DPL) to provide our protected lifetime income solutions to independent registered investment advisors (RIAs). The collaboration expands Jackson's distribution footprint and provides Jackson with access to new opportunities in the independent RIA channel.

Regional broker dealers and wirehouses

Jackson's Regional Broker Dealer (RBD) team provides dedicated service and support to regional brokerage firms and wirehouses. Regional broker dealers are a hybrid between independent broker dealers and wirehouses. Like representatives who work for wirehouses, financial representatives at regional broker dealers are employees of the firm. However, unlike wirehouses, RBD firms have limited institutional investment banking services. The RBD team develops relationships with regional firms throughout the US and provides customised materials and support to meet their specialised advisory needs.

Jackson's RBD team supports more than 40,000 representatives in regional broker dealers and wirehouses.

Banks, credit unions and other financial institutions

Jackson's Institutional Marketing Group distributes annuity products through banks, credit unions and other financial institutions and through third party marketing organisations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and at 31 December 2018 had access to more than 29,000 financial institution representatives through existing relationships with banks and credit unions. Jackson has established distribution relationships with medium sized regional banks, which it believes are unlikely to develop their own insurance product capability.

Institutional products department

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

PPM

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

Regulatory landscape

The industry has continued to manage through an ever-changing regulatory landscape. In 2016, the US Department of Labor (DoL) released a final version of its Fiduciary Duty Rule (Rules), which sought to eliminate conflicts of interest in investment advice, in order to protect and encourage savings and investment for working Americans. These Rules were rescinded in 2018. However, other alternative proposals, such as the US Securities and Exchange Commission's (SEC) best interest standard, remain pending.

As a result of an improved regulatory outlook, rising interest rates and more aggressive product feature changes (ie withdrawal percentages) implemented by competitors, the annuity industry saw increased sales in

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2018 (albeit still well below levels prior to the DoL Rules proposal). Sales in the variable annuity industry as of the third quarter of 2018 at US$75.4 billion[4] were up 4 per cent compared with the same period last year.

Regardless of the outcome of the SEC best interest standard, the regulatory disruption caused by the now rescinded DoL Rules has challenged the industry to review the ways in which investment advice is provided to American investors. Manufacturers will need to have the ability to provide product and system adaptations in order to support the success of various distribution partners in their delivery of invaluable retirement strategies that investors need. Because of its strong distribution, leadership in the annuities market, best-in-class service and a low-cost efficient operation, we believe that Jackson is well positioned to take advantage of this opportunity.

Furthermore, in late 2018, the US National Association of Insurance Commissioners (NAIC) concluded an industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and enhancing risk management. The NAIC is targeting a January 2020 effective date for the new framework in order to allow adequate time for the drafting and implementation of the revised regulations and instructions with a potential three-year phase-in. The NAIC also has an ongoing review of the C-1 bond factors in the required capital calculation, on which further information is expected to be provided in due course. Despite these regulatory challenges, we believe that Jackson is well positioned to manage the impact of these regulatory changes.

Investment for growth

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

In September 2018, Jackson announced a technology integration collaboration with Envestnet® allowing Jackson to offer its complete product suite of advisory annuities on the Envestnet Insurance Exchange. The new collaboration brings together a leading provider of annuities in the US, with the leading provider of intelligent systems for wealth management and financial wellness. Jackson is working with Envestnet to make annuities easier to work with inside of a client's portfolio. Advisers will be able to create more value for their clients by holistically considering longevity risk, sequence of returns risk, market risk and mortality risk within the Envestnet wealth management platform.

The acquisition of John Hancock's group payout annuity business in late 2018 represents a reaffirmation of Jackson's growth bolt-on strategy and continuing commitment to deploy capital at attractive return levels. This transaction further diversifies Jackson's risk portfolio and revenue sources in relation to both general and separate account businesses.

With the ever-changing regulatory environment described earlier, Jackson has made and continues to consider changes to its product offerings, entered into new selling agreements with advisory providers, and is working with its distributors to support implementation of the anticipated SEC best interest standard.

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

Disciplined risk management

Jackson operates within a well-defined risk framework aligned with the overall Prudential Group risk appetite. Jackson contemplates the expected cost of hedging when pricing its products and charges fees for these guarantees which are used, as necessary, to purchase downside protection in the form of options and futures to mitigate the effect of equity market falls, and swaps and swaptions to cushion the impact of declines in long-term interest rates.

Jackson's hedging or derivative programme is used to manage interest rate risk associated with a broad range of products and equity market risk attaching to its equity-based products, as explained further in note C7.3 to the consolidated financial statements. Jackson is able to aggregate financial risks across the company, obtain

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a unified view of our risk positions, and actively manage net risks through an economically-based hedging programme. A key element of our core strategy is to protect the company from severe economic scenarios while maintaining adequate regulatory capital. We benefit from the fact that the competitive environment continues to favour companies with robust financial strength and a demonstrated track record of financial discipline, both key elements of our long-term strategy.

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

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

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

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

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

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

Lowering crediting rates helps to mitigate the effect of spread compression, but the spreads could still decline as Jackson is typically only entitled to reset the crediting rates at limited pre-established intervals and the re-setting is subject to the guaranteed minimum rates. As at 31 December 2018, approximately 87 per cent of Jackson's fixed annuities, variable annuity fixed account options and interest-sensitive life business account values correspond to crediting rates that are at the minimum guaranteed interest rates (2017: 87 per cent). Tabular disclosures are provided above on the distribution of the account values of these businesses within the range of their contractual minimum guaranteed interest rates. The tables demonstrate that approximately 72 per cent (2017: 72 per cent) of Jackson's combined fixed annuities, variable annuity fixed account options and interest sensitive life business account values of £25 billion (2017: £24 billion) have contractual minimum rates of 3 per cent or less.

Jackson's expectation for future spreads is also an important component in the amortisation of deferred acquisition costs. Significantly lower spreads may cause it to accelerate amortisation, thereby reducing total IFRS profit in the affected reporting period. Low market interest rates could also reduce Jackson's return on investments that are held to support the company's capital. In addition, changes in interest rates will affect the

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net unrealised gain or loss position of Jackson's available-for-sale fixed income securities, which is reported as a component of other comprehensive income. Further information on the factors affecting the pricing of products and asset liability management of Jackson is provided below.

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

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

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

The profitability of Jackson's fee-based business depends largely on its ability to manage equity market risk. As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of guarantees. In addition to being a profitable book of business, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business to effectively manage Jackson's equity exposure. Jackson believes that the internal management of equity risk, coupled with the utilisation of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure. Profits in the variable annuity book of business will continue to be subject to the impact of market movements both on sales and allocations to the variable accounts and the effects of the economic hedging program. While Jackson hedges its risk on an economic basis, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility.

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

Factors affecting pricing of products and asset liability management

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

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

Jackson segregates its investment portfolio for certain investment management purposes, and as part of its overall investment strategy, into four portfolios: life and fixed annuities without market value adjustment, fixed annuities with market value adjustment, fixed index annuities and institutional liabilities. The portfolios backing life and fixed annuities with and without market value adjustments and the fixed index annuities have similar characteristics and differ primarily in duration. The portfolio backing the institutional liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the institutional portfolio is managed to permit less interest rate sensitivity and has limited exposure to mortgage backed securities. At 31 December 2018, less than one per cent of the institutional portfolio was invested in residential mortgage backed securities.

The fixed-rate products may incorporate surrender charges, market value adjustments, two-tiered interest rate structures or other limitations relating to when policies can be surrendered for cash, in order to encourage persistency. As of 31 December 2018, 49 per cent of Jackson's fixed annuity reserves had surrender penalties or other withdrawal restrictions. Substantially all of the institutional portfolio had withdrawal restrictions or market value adjustment provisions.

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

Guaranteed benefits issued by Jackson in connection with the sales of variable annuity contracts expose Jackson to equity risk as the benefits generally become payable when equity markets decline and contract values fall below the guaranteed amount. The accounting measurement of the liability for certain of these benefits differs from a true fair value calculation with changes in value recorded in income. Jackson manages the exposure of the tail risk associated with the equity exposure using equity options and futures contracts, which are also carried at fair value. Jackson seeks to manage the economic risk associated with these contracts and, therefore, has not explicitly hedged its fair value risk as determined under accounting rules. In addition, certain benefits have mortality risk and are therefore precluded from being carried at fair value. As a result of these factors, the income statement may include a timing mismatch related to changes in fair value. However, as demonstrated during the economic crisis, subsequent rebound and recent volatility in the equity markets, Jackson's hedges have effectively operated as designed.

Notes

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3

Independent research and Market Metrics, a Strategic Insight Business: U.S. Advisor Metrics 2018, as of 30 September 2018.

4

LIMRA/Secure Retirement Institute, US Individual Annuity Participants Report 3Q YTD 2018.

5

Source: Third Quarter 2018 SNL Financial.

United Kingdom and Europe

Introduction

M&GPrudential is the UK and Europe savings and investments business of Prudential plc. It was formed in 2017 through the merger of Prudential's UK and Europe insurance operations with M&G Investments, Prudential's international asset manager.

Our business manages total assets of £321 billion[1] and serves more than six million customers worldwide. M&GPrudential offers savings and investment products for individuals who want to build and protect their life savings. We provide innovative asset management and customer solutions, supported by strategic asset allocation, an international distribution network and two strong brands.

In March 2018, the Board of Prudential plc announced its intention to demerge M&GPrudential. The Prudential Board believes the demerger will further strengthen two already strong businesses. For M&GPrudential, the demerger will enable our leadership team to focus solely on what is important to our customers, give us direct control over our own capital and enable us to pursue growth opportunities without competing for resources with other Prudential plc businesses. M&GPrudential is expected to have a premium listing on the London Stock Exchange.

We see a huge opportunity in the growing savings gap across Europe. As support from the state diminishes and employers gradually retreat from guaranteed retirement provisions, more and more people need to make their own preparations for retirement and other life goals. At the same time, many people with sizeable asset pools, who want to grow or protect their value, seem to be keeping their money in cash despite the negative real return. Across the EU, there is an estimated €10 trillion[2] of cash sitting, largely idle, in bank deposits at very low interest rates.

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We believe M&GPrudential is well placed to help our customers build and protect their savings because of the mix of our businesses, capabilities and people. We combine the best of fund management with compelling customer propositions in a highly collaborative culture. Our competitive advantages arise from the strength and depth of this business mix built over many years.

We have a full set of diversified investment capabilities with expertise spanning a range of fixed income, equity, multi-asset, real estate and private asset classes. We are one of the largest multi-asset managers in Europe through the £131 billion Prudential With-Profits Fund and our range of branded M&G funds, and manage £59 billion of private assets, including an international real estate portfolio. We are a UK market leader in savings solutions with our PruFund proposition, a modern way of with-profits investing. We also have one of the fastest growing advised platforms[3] in the UK, reaching £13.3 billion in assets under administration in the 24-month period since launch. We have a growing international distribution network with multi-channel breadth and depth, and two of the strongest brands in the market.

Building on these competitive advantages, M&GPrudential's priorities in 2019 will be:

- To continue to serve our customers well, by improving outcomes and service levels, and widening product choice;
- To advance our merger and transformation programme, to modernise the business so that we become a simpler, lower-cost, digital organisation; and
- To prepare M&GPrudential for demerger and its future as an independent company with its own listing on the stock market.

Market overview

M&GPrudential serves the world's largest savings and investments markets, with a focus on UK and Europe. Across the region, people increasingly need help to meet their long-term financial goals as responsibility for retirement savings passes from state and employer to the individual.

Customers in our markets demand easy access to savings and investment solutions, as well as guidance and advice from trusted providers. In addition, persistently low rates of return on bank cash deposits are fuelling demand for effective solutions, whether clients are saving for retirement, building a lump sum or protecting their wealth from inflation.

In the institutional market, clients are increasingly seeking bespoke solutions from asset managers with diversified investment capabilities and global reach. The combination of M&GPrudential's expertise in private assets, which are much in demand in this sector, and our growing international network of offices means we are well placed to serve these clients.

Customers

We serve a wide range of customers: individuals saving for retirement and other life goals; retirees who want to draw down on their accumulated savings; professional intermediaries who manage the savings of their own customers; pension funds; and other institutional clients with future, long-term financial commitments.

What all our customers have in common is the desire for professional help to build and protect their savings with confidence. Our approach is to offer a broad range of products and services, in a variety of formats, through multiple distribution channels all backed by the same in-house investment expertise and capability.

Our customers fall into five broad categories:

- UK retail advised customers who are saving for retirement or who want to draw down on their accumulated savings. They typically invest in our market-leading PruFund, which offers smoothed, long-term returns adjusted for different risk tolerances;
- UK retail advised and direct customers who invest for the long term through our range of M&G-branded mutual funds. This group includes about 160,000 customers who invest directly with our fund management business;
- Customers of our traditional insurance business in the UK. Numbering six million, these customers typically hold a Prudential annuity, which pays an income for life, or an insurance-wrapped savings bond;

Wholesale clients in Europe and Asia. These include retail banks, private banks, wealth managers, independent advisers and fund platforms. We manage £38 billion on behalf of these clients' own customers; and

Pension funds and other institutional clients, who invest on behalf of their scheme members. We have nearly 900 such relationships, including 70 per cent of the UK's largest pension schemes[4].

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In 2019, we will continue to improve service levels and launch new offerings. In the UK retail market, we will broaden the choice of tax wrappers and products on our own adviser platform. In November, we made M&G's range of mutual funds available for the first time on the Prudential adviser platform and in January, we launched PruFolio, a new range of passive, active and smoothed return funds.

For customers of our traditional insurance business, our modernisation programme is already improving service levels. Deployment of new digital technology has reduced markedly the time it takes to process a redemption from a Prudential savings bond. Customers can now register for our MyPru online service in minutes.

During 2018, we transferred £21 billion of our key European fund offerings into new Luxembourg-based SICAVs, with the process expected to be completed as planned in the first quarter of 2019. This positions us well to minimise any potential disruption for our European clients stemming from the UK's withdrawal from the European Union, while also creating a more flexible and robust platform for international growth.

Our investment solutions

The core engine of our business is a long-standing collaboration between our fund managers and the strategic asset allocators who oversee the investment of the Prudential life funds. This symbiotic relationship enables us to diversify our investment capabilities and to innovate by developing high-quality products for all customers.

Our investment capabilities span the traditional public markets, from cash through fixed income and on to international equities. We also have a large range of private asset capabilities with £59 billion of assets under management, covering real estate, private debt, corporate loans and infrastructure investments such as broadband and solar energy.

This breadth of our investment capability underpins many of our customer offerings. It reinforces the reliability of the returns from our £131 billion With-Profits Fund, which is one of Europe's largest multi-asset portfolios for retail savers[5]. The With-Profits Fund has produced a cumulative gross return of 129.5 per cent over 10 years[6] before tax and charges compared with a 121.4 per cent return from the FTSE 100 Index over the same period, not allowing for any management fees. A key component of this performance is PruFund. Launched over 10 years ago, PruFund is a transparent and modern way of with-profits investing in the UK, which has since become the fastest-growing savings and investment proposition across the Group.

PruFund offers individuals different rates of smoothed return aligned with their tolerance for risk. In 2019, we aim to enhance advisers' access to PruFund by significantly upgrading our digital services across a range of tax wrappers. We are also exploring with European distributors, how we might make the benefits of PruFund available to savers in their markets. Today, assets under management in PruFund top £43 billion after attracting £8.5 billion of net inflows during 2018.

The With-Profits Fund has acted as an incubator for other products too. Among these are a range of investment strategies based on private asset investments such as real estate, infrastructure assets and private debt and marketed to clients seeking this type of exposure.

We are seeing strong demand from pension funds for our private asset products because they are seeking higher yields to manage long-term liabilities. These types of investment strategy remain comparatively resilient to fee pressure because they are not easy for passive investment managers to replicate as they involve securing real and private assets.

During 2018, we continued to expand our range of mutual funds for retail investors. These included the innovative M&G Positive Impact Fund, which widens access to impact investing for retail customers who want to invest in companies that aim to have a positive impact on society, and the M&G Sustainable Allocation Fund, a multi-asset fund incorporating environmental, social and governance factors. We also launched an investment trust, M&G Credit Income Investment Trust, which for the first time allows UK retail investors to put their money into a combined portfolio of public and private debt.

Responding to the growing institutional client demand for social and environmental investment strategies, we also launched the M&G Impact Financing Fund, which was awarded Best New Entrant (Fund) at the Sustainable and ESG Investment Awards 2018. Total assets under management at 31 December 2018 were £321 billion[1] (31 December 2017: £351 billion), reflecting inflows to PruFund products, multi-asset wholesale offerings and other institutional business, more than offset by the expected redemption of a single low-margin institutional mandate and outflows from bond and equity funds in volatile financial markets.

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Refer to 'Additional information on the long-term products of M&GPrudential' for further details on products.

Distribution

At M&GPrudential, we have two outstanding complementary brands, both of which share a common philosophy of aiming to deliver excellent long-term customer outcomes.

Currently, we choose to serve our customers' needs through our many business-to-business relationships. These relationships include thousands of independent financial advisers, most of the high-street banks, wealth managers, institutional investment managers and pension funds. Two years ago, we established an adviser platform in the UK to give the market better access to PruFund. Since then, we have diversified the range of products on the platform to include M&G mutual funds. In 2018, it was among the fastest growing platforms in the UK, reaching £13.3 billion of assets under administration.

Outside the UK, we distribute our investment products with the support of our financial advisers, independent asset managers, insurers and some of the world's largest banks. From a standing start just under two decades ago, we have built an international distribution network to distribute M&G products and support clients in 29 markets, with offices most recently opened in Australia and the United States. Our new Luxembourg investment platform, as well as readying our business for Brexit, enables us to distribute our mutual funds more efficiently in Europe and beyond by offering our investment strategies in the SICAV format favoured by many of our clients.

Update on business transformation and demerger

Our business modernisation programme is well advanced and already showing service benefits for customers. In January 2018, we announced a new partnership with Tata Consultancy Services to transfer, consolidate and upgrade the customer administration systems for our traditional insurance business. This involved the transfer of 2,500 people, including 650 Prudential colleagues.

Each day, we move closer to our model of a simpler, lower-cost, digital organisation. The impact on customer outcomes is already evident. Examples include: a new digital service for investment bond customers that has reduced cash withdrawal waiting times by almost 80 per cent; changes to our bereavements processes, which are saving our customers 200,000 days of their time each year; and delivery of simplified annual benefit statements for more than one million Prudential customers. M&GPrudential 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.

The build of our corporate infrastructure is well advanced. The M&GPrudential leadership team is in place, a new governance model has been implemented and we have built a set of unified corporate support services.

In September, we announced the appointment of an M&GPrudential Chair, Mike Evans. During the first half of 2019, the recruitment of the board will begin for the new listed company, including the appointment of independent non-executive directors including the heads of the key committees.

Additional information on the long-term products of M&GPrudential

Long-term products

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

	Year Ended 31 December £m		
	2018	**2017**	**2016**
Individual annuities	**203**	223	546
Bonds	**3,539**	3,509	3,834
Corporate Pensions	**186**	233	231

Individual Pensions	**5,716**	5,779	2,567
Income drawdown	**2,555**	2,218	1,649
Other products	**1,360**	1,269	1,186
Total new business premiums	**13,559**	13,231	10,013

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Of the total new business premiums of £13,559 million (2017: £13,231 million; 2016: £10,013million), £13,382 million (2017: £13,044 million; 2016: £9,836 million) were for single premiums and £177 million (2017: £187 million; 2016: £177 million) were for regular premiums.

Pension annuities

Following the decision taken in 2016 to curtail retail sales of annuity business, during 2017, M&GPrudential introduced an annuity service which gives retiring customers access to a panel of annuity providers rather than access to a M&GPrudential's annuity. This has been rolled out to approximately 50 per cent of the pension books.

M&GPrudential offers conventional annuities which include level (non-increasing), fixed increase and RPI annuities. In 2018, new business premiums for these conventional annuities were £203 million (2017: £223 million).

Bonds

Onshore Bonds

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

PIP also gives financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In addition M&GPrudential offers an open architecture onshore bond, the Prudential Onshore Portfolio Bond (POPB), which allows customers to access a wide range of quoted UK investments. New business premiums from this product were £49 million in 2018 (2017: £80 million). In total in 2018, new business premiums from the unit-linked option within on-shore bond wrappers, including PIP and POPB, were £152 million (2017: £186 million).

M&GPrudential offers a unitised and smoothed with-profits investment fund called PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer with a choice of Cautious, Growth or Risk-Managed funds. PruFund also offers clients an optional guarantee on the initial investment in either the Cautious or Growth funds with terms between ten and fifteen years. PruFund is available across M&GPrudential's range of tax wrappers including individual pensions, income drawdown, ISA, onshore and offshore bonds. In 2018, total bonds new business premiums attributable to PruFund, including new business through PIP, was £2,397 million (2017: £2,342 million). The new business premiums for other onshore bonds were £53 million in 2018 (2017: £132 million).

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

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

Offshore Bonds

M&GPrudential's offshore bond products are the Prudential International Investment Bond and the Prudential International Investment Portfolio offering clients access to a wide range of quoted UK investments. M&GPrudential's offshore bond sales rose by 10 per cent to £937 million in 2018 (2017: £849 million).

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Pension and income drawdown products

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

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

Income drawdown products have historically provided a 'bridge' between pensions and annuities, allowing customers to access pension savings from age 55, subject to certain limits. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth. Income drawdown has proved popular with customers seeking greater flexibility than that offered by a traditional annuity product, but preferring to draw funds gradually rather than withdrawing all of their savings as cash. Depending on the size of their pension pot and the individual's tax position, it may also be more tax efficient for a customer to invest in a drawdown product rather than to take cash. Many of the pension products M&GPrudential offers are with-profits products or offer the option to have all or part of the contributions allocated to the with-profits fund. Where funds invested in the with-profits fund are withdrawn prior to the pension date specified by the policyholder, M&GPrudential may apply a market value adjustment (MVA) to the amount paid out. MVAs do not apply to the PruFund investment options. The remaining pension products are non-participating products, which include unit-linked products.

Individual pensions and income drawdown

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

M&GPrudential launched its new Retirement Account proposition, which offers one account for both pension savings and income drawdown and can accept transfers from existing plans, to the intermediated market, including its own advised sales force, PFP, in the third quarter of 2016. It is a digital proposition with an open charging structure separating charges out for the tax wrapper, funds and guarantees and offers improved service to advisers and customers. To meet customers' needs for secure income whilst still retaining some flexibility, a minimum income guarantee is offered as an additional option. The overall proposition, both with and without the minimum income guarantee option, has been well received in the market, securing significant sales since launch and accounting for 88 per cent of total individual pension and income drawdown sales in 2018.

For products with drawdown features, the investment risk and mortality risk remains with the policyholder, payments are not guaranteed, and tend to cost more to administer. In the past, this has meant that the option to draw down income tended to apply mainly to more sophisticated policyholders, commonly with larger retirement funds. The changes in the rules governing access to pension savings mean that consumers now have more choice and flexibility in how they access their retirement income and drawdown has become more popular for customers starting to take income in retirement. Any income taken from pension savings in excess of the allowable tax-free lump sum is taxable at a customer's marginal tax rate.

PruFund is available across M&GPrudential's range of individual pensions and income drawdown tax wrappers and accounts for the majority of the new business premiums of these two categories.

Corporate Pensions

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

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Other products

PruFund ISA

The PruFund range of investment funds was added to the Prudential ISA in February 2015, to offer clients a level of smoothing within a tax efficient wrapper. New business premiums in 2018 were £1,330 million (2017: £1,246 million).

Shareholders' interests in M&GPrudential's long-term insurance business

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

With-profits products

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

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

In addition to the with-profits policies described above, the with-profits sub-fund also contains the PruFund range of with-profits contracts, which offer policyholders a choice of investment profiles. Unlike the more traditional with-profits contracts, no regular or final bonuses are declared. Policyholder return is determined by an Expected Growth Rate (EGR) which is declared quarterly. A different EGR is applied for each of the PruFund funds within the range, each relating to the individual asset mix of that fund. The relevant EGR is applied to increase the unit value of policyholder funds, calculated daily. In normal investment conditions the EGR is expected to reflect PAC's view of how the funds will perform over the longer term. An adjustment is made to the smoothed unit value if it moves outside of a specified range relative to the value of the underlying assets.

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

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

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

- The cost of mortality risk and other guarantees (where applicable);
- The effect of taxation;
- Management expenses, charges and commissions;
- The proportion of the amount determined to be distributable to shareholders; and

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

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

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

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

In 2018, PAC declared a total surplus of £2,669 million (2017: £2,385 million) from PAC's primary with-profits sub-fund, of which £2,410 million (2017: £2,152 million) was added to with-profits policies and £259 million net of tax (2017: £233 million) was distributed to shareholders of which 17 per cent was from PruFund business (2017:15 per cent). These amounts included annual bonus rates of 1.5 per cent for the whole year for Prudence Bond and 1.5 per cent for the whole year for personal pensions.

The closed Scottish Amicable Insurance Fund (SAIF) declared total bonuses in 2018 of £328 million compared with £354 million in 2017. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business.

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

Surplus assets in PAC's with-profits fund

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

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

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

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

Matters relating to with-profits sub-funds:

Pension mis-selling review   the UK insurance regulator required all UK life insurance companies to review sales of personal pensions policies for potential mis-selling. Offers of redress to all cases were made by 30 June 2002. Whilst Prudential believed it met the regulator's requirements to issue offers of redress to all customers by 30 June 2002 there is a population of customers who, whilst an attempt was made at the time, to invite them to participate in the review, may not have received their invitation. These customers are being re-engaged to ensure that they have the opportunity to take part in the review. Costs arising from this review are met by the excess assets of the UK with-profits sub-fund and hence have not been charged to the asset shares used in the determination of policyholder bonus rates. Prudential has given an assurance that these deductions from excess assets will not impact its bonus or investment policy for policies within the with-profits sub-funds that were in force at 31 December 2003. This assurance does not apply to new business since 1 January 2004. In the unlikely event that such deductions would affect the bonus or investment policy for the relevant policies, Prudential has stated it would make available support to the sub-fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged;

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

In addition, certain pensions products within this sub-fund have guaranteed annuity rates at retirement, for which a provision of £361 million was held within the sub-fund (31 December 2017: £503 million); and

Guaranteed annuities a provision for guaranteed annuity products of £49 million was held (31 December 2017: £53 million) in the UK with-profits sub-fund.

Intra-group capital support arrangements

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

Non-participating business

The profits from almost all of the new non-participating business accrue solely to shareholders.

Notes

1. Represents M&GPrudential asset management external funds under management and internal funds included on the M&GPrudential long-term insurance business balance sheet.
2. Household deposit data, Eurostat 2017.
3. UK Advised Platform Market data, Platforum, Q3 2018.
4. Based on the UK's Top 50 Pension Schemes by size, S&P Money Market Directory, June 2018.
5. M&GPrudential analysis comparing our largest with-profits fund with other European mixed asset funds with data from Financial Express.
6. Performance data for Prudential with-profits fund excludes hypothecated asset pools of Optimum Bonus fund and Risk-Managed PruFunds. Returns are shown before of charges.

Competition

General

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

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

- Price and yields offered;
- Financial strength and ratings;
- Commission levels, charges and other expenses;
- Range of product lines and product quality;
- Brand strength, including reputation, quality of service and use of technological advances;
- Distribution channels;
- Investment management performance; and
- Historical bonus/contract enhancement and bonus interest levels.

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

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

Asia

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

Prudential's principal competitors in the Asia Pacific region include global life insurers such as Allianz, AXA and Manulife together with regional insurers such as AIA, FWD and Great Eastern, and multinational asset managers such as Franklin Templeton, HSBC Global Asset Management, J.P. Morgan Asset Management and Schroders. In most markets, there are also local companies that have a material market presence eg China Life, China Pacific and Ping An in China, HSBC Life in Hong Kong and Muang Thai Life.

US

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

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

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

UK and Europe

M&GPrudential's principal competitors include many of the major retail financial services companies and fund management companies operating in the UK. These companies include Aviva, Janus Henderson, Jupiter, Legal & General, Schroders and Standard Life Aberdeen. Prudential competes with other providers of financial products to be included on financial advisors' panels of preferred providers.

Sources

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

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FINANCIAL REVIEW

Overview

Prudential's financial performance in 2018 reflects our strategic focus on driving growth in high-quality, recurring health and protection and fee business across our geographies, products and distribution channels. Prudential's financial performance has been accomplished at the same time as the Group has made good progress in the complex preparations for the intended demerger of M&GPrudential from Prudential plc, which we announced in March 2018.

Our financial performance was led by our Asia business which delivered double digit growth in adjusted IFRS operating profit based on longer-term investment returns. Our Asia asset manager, Eastspring, has grown adjusted IFRS operating profit based on longer-term investment returns amidst a challenging external environment. In the US, we saw growth in fee income driven by higher average account balances offset by an increase in market-related deferred acquisition costs (DAC) amortisation and an expected reduction in spread-based revenues, leading to a fall in adjusted IFRS operating profit based on longer-term investment returns. M&GPrudential delivered adjusted IFRS operating profit based on longer-term investment returns of £1,634 million, up 19 per cent (2017: £1,378 million). This included £519 million (2017: £597 million) from our core[1] with-profits and annuity business, with the with-profits contribution up 11 per cent to £320 million, offset by lower annuities earnings following the reinsurance of £12 billion[2] of liabilities in March 2018.

We provide a discussion of our financial performance in 2018 in this section, which is organised as follows:

- IFRS Critical Accounting Policies
- Summary Consolidated Results and Basis of Preparation of Analysis
- Explanation of Movements in Profit after Tax and Profit before Shareholder Tax by Reference to the Basis Applied for Segmental Disclosure
- Basis of Performance Measures
  - Determination of adjusted IFRS operating profit based on longer-term investment returns for investment and liability movements
  - Analysis of adjusted IFRS operating profit based on longer-term investment returns
- Explanation of performance and other financial measures
  - Earnings per share
  - Adjusted IFRS operating profit based on longer-term investment returns
  - Short-term fluctuation in investment returns on shareholder-backed business
  - Group and Holding Company Cash Flows
  - Capital Position, Financing and Liquidity
- Explanation of Movements in Profit before Shareholder Tax by Nature of Revenue and Charges
- EEV Basis, New Business Results and Free Surplus Generation
- Additional Information on Liquidity and Capital Resources

Notes

1 Core refers to the underlying profit of the UK and Europe insurance business, excluding the effect of, for example, management actions to improve solvency and material assumption changes. Details of these are set out in note I(d) of the Additional unaudited financial information.

2 Relates to IFRS shareholder annuity liabilities, valued as at 31 December 2017.

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IFRS Critical Accounting Policies

Prudential's discussion and analysis of its financial condition and results of operations are based upon Prudential's consolidated financial statements, which have been prepared in accordance with IFRS as issued by the IASB and as endorsed by the EU (EU-endorsed IFRS). EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2018, there were no unendorsed standards effective for the three years ended 31 December 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. 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, revenues and expenses, which are both recognised and unrecognised (eg contingent liabilities) in the primary financial statements. 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 that can potentially give rise to different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to the policies referenced below which are described further in the notes to the consolidated financial statements.

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

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

In determining the measurement of the Group's assets and liabilities and in preparing financial statements, more generally, estimates and judgements are required. Our critical accounting estimates and assumptions are those set out below, with a reference to the detailed discussion in the notes to our consolidated financial statements.

Critical accounting estimates and assumptions	**Reference to the disclosure notes in the consolidated financial statements**
Classification of insurance and investment contracts	A3.1(a)
Measurement of policyholder liabilities and unallocated surplus of with-profits funds	A3.1(a); and C4.2
Deferred acquisition costs for insurance contracts	A3.1(c); and C4.2
Financial investments Valuation	A3.1(c)

Financial investments	Determining impairment in relation to financial assets	A3.1(c)
	Additional quantitative information on the impairment and realised gains/losses recognised on the available-for-sale debt securities of US insurance operations	B1.2
	Additional quantitative information on the movement in the statement of financial position value of the available-for-sale debt securities of US insurance operations and those which are in a gross unrealised loss position.	C3.2(b), C3.2(c)
Intangible assets	Carrying value of distribution rights	A3.1(c)

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Summary Consolidated Results and Basis of Preparation of Analysis

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

	Year Ended 31 December £m (AER)		
	2018	**2017**	**2016**
Total revenue, net of reinsurance	**24,931**	86,390	71,718
Total charges, net of reinsurance and (loss) profit attaching to disposal of businesses	**(21,913)**	(82,722)	(68,688)
Share of profits from joint ventures and associates, net of related tax	**291**	302	182
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)* *	**3,309**	3,970	3,212
Tax attributable to policyholders' returns	**326**	(674)	(937)
Profit before tax attributable to shareholders	**3,635**	3,296	2,275
Tax charge (credit)	**(296)**	(1,580)	(1,291)
Less: tax attributable to policyholders' returns	**(326)**	674	937
Tax charge attributable to shareholders' returns	**(622)**	(906)	(354)
Profit for the year	**3,013**	2,390	1,921

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

Under IFRS, the pre-tax GAAP measure of profit 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 tax or other policy taxes.

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

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

(a)

Group overview

2018 compared with 2017

Profit for the year after tax for 2018 was £3,013 million compared with £2,390 million for 2017 on an AER basis. The increase primarily reflects the movement in profit before tax attributable to shareholders, which increased from a profit of £3,296 million in 2017 (on an AER basis) to a profit of £3,635 million in 2018 and a decrease in the tax charge attributable to shareholders from £906 million in 2017 to £622 million in 2018.

On an AER basis, the increase in the total profit before tax attributable to shareholders from £3,296 million in 2017 to £3,635 million in 2018 reflects an increase in adjusted IFRS operating profit based on longer-term investment returns of £128 million or 3 per cent, which was further improved by a decrease in non-operating losses of £211 million, from a loss of £1,403 million to a loss of £1,192 million. The reduction in non-operating losses of £211 million is primarily attributable to a favourable change in short-term fluctuations in investment returns of £1,005 million from negative £1,563 million in 2017 to negative £558 million in 2018 partially offset by an increase in the loss on disposal of businesses and corporate transactions from a gain of £223 million in 2017 to a loss of £588 million in 2018. The loss on disposal of businesses and corporate transactions in 2018 relates primarily to the £508 million pre-tax loss following the reinsurance of UK annuities to Rothesay Life in March 2018.

The increase of £128 million or 3 per cent in the Group adjusted IFRS operating profit based on longer-term investment returns includes a positive exchange translation impact of £149 million. Excluding the effect of currency volatility, on a CER basis, Group adjusted IFRS operating profit based on longer-term investment returns increased from £4,550 million to £4,827 million, 6 per cent higher than the equivalent amount in 2017 reflecting increases from continued business momentum in Asia and a number of beneficial impacts that are not expected to recur at the same level in M&GPrudential partially offset by a decrease in the US as a result of higher market-related DAC amortisation charges.

The effective rate of tax on the total profit attributable to shareholders is 17 per cent in 2018 (2017: 14 per cent after excluding the one-off impact of the remeasurement of US deferred tax balances following the enactment in December 2017 of tax reform in the US). The increase in the 2018 effective tax rate is due to non-tax deductible investment losses in Asia. Further details are provided in note B4 of the consolidated financial statements.

2017 compared with 2016

Profit for the year after tax for 2017 was £2,390 million compared with £1,921 million for 2016. The increase primarily reflected the movement in profit before tax attributable to shareholders, which increased from a profit of £2,275 million in 2016 to a profit of £3,296 million in 2017, partially offset by an increase in the tax charge attributable to shareholders from £354 million in 2016 to £906 million in 2017.

The increase in the total profit before tax attributable to shareholders from £2,275 million in 2016 to £3,296 million in 2017 reflected an improvement in adjusted IFRS operating profit based on longer-term investment returns of £443 million from £4,256 million in 2016 to £4,699 million in 2017 and a decrease in non-operating losses of £578 million, from negative £1,981 million to negative £1,403 million. The decreased charge for non-operating items of £578 million was primarily attributable to the profit attaching to disposal of businesses of £162 million in 2017 compared with a loss of £227 million in 2016 and the favourable change in short-term fluctuations in investment returns of £115 million from negative £1,678 million in 2016 to negative £1,563 million in 2017. The increase of £443 million or 10 per cent in adjusted IFRS operating profit based on longer-term investment returns included a positive exchange translation impact of £173 million. Excluding the effect of currency volatility, on a CER basis, the Group adjusted IFRS operating profit based on longer-term investment returns increased by £270 million or 6 per cent to £4,699 million, reflecting the increases across the Group's businesses.

The effective rate of tax at the total profit level was 27 per cent in 2017 compared with 16 per cent in 2016. The increased rate principally reflected the inclusion of a £445 million one-off charge on the remeasurement of US deferred tax balances following the enactment of a tax reform in December 2017. Excluding this one-off charge, the 2017 effective tax rate would have been 14 per cent. Further details are provided in note B4 of the consolidated financial statements.

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(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&GPrudential for the day-to-day management of their business units (within the framework set out in the Group Governance Manual). Financial management information used by the GEC aligns with these three business segments. These operating segments derive revenue from both long-term insurance and asset management activities.

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

The following table shows Prudential's IFRS consolidated total profit (loss) presented by business segment. The accounting policies applied to the segments below are the same as those used in the Group's consolidated financial statements.

	Year Ended 31 December £m		
	2018	**2017**	**2016**
Asia	**1,360**	1,775	928
US	**1,484**	254	591
UK and Europe	**944**	1,097	1,184
Total profit attributable to the segment	**3,788**	3,126	2,703
Unallocated to a segment*	**(775)**	(736)	(782)
Total profit for the year	**3,013**	2,390	1,921

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

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

Asia

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

	Year Ended 31 December £m		
	2018	**2017**	**2016**
Insurance operations	**1,455**	1,852	1,043
Asset management	**182**	176	141
Profit before shareholder tax	**1,637**	2,028	1,184
Shareholder tax charge	**(277)**	(253)	(256)

Profit after tax	**1,360**	1,775	928

2018 compared with 2017

The decrease of £415 million in the profit after tax from £1,775 million in 2017 to £1,360 million in 2018 primarily reflects a decrease in the profit before shareholder tax of £391 million from £2,028 million to £1,637 million and an increase in shareholder tax charge by £24 million to £277 million in 2018 from £253 million in 2017.

The decrease in profit before shareholder tax includes a decrease of £397 million in insurance operations from £1,852 million to £1,455 million marginally offset by an increase of £6 million in asset management operations from £176 million to £182 million.

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For the Asia insurance operations, the assets and liabilities of contracts classified as insurance under IFRS 4 are determined in accordance with methods prescribed by local GAAP and adjusted to comply, where necessary, with grandfathered UK GAAP. Under IFRS 4, subject to the conditions of that standard, the continued application of grandfathered UK GAAP in this respect is permitted. In some operations ie Taiwan and India, US GAAP principles are applied. For with-profits business in Hong Kong, Singapore and Malaysia, the basis of profit recognition is bonus driven as described under 'UK and Europe Basis of Profits' below.

The decrease of £397 million in the profit before shareholder tax of insurance operations primarily reflects an unfavourable movement in non-operating items of £580 million from a gain of £53 million in 2017 to a loss of £527 million in 2018. This is partially offset by an increase of adjusted IFRS operating profit based on longer-term investment returns of £183 million from a profit of £1,799 million in 2017 to £1,982 million in 2018. The unfavourable change in non-operating items were primarily due to an increase in short-term fluctuations in investment returns from negative £1 million to negative £512 million, following falls in equity markets and unrealised bond losses in the period due to rising interest rates in many markets in Asia. The increase of £183 million in adjusted IFRS operating profit based on longer-term investment returns includes a negative exchange translation impact of £72 million. Excluding the currency volatility, adjusted IFRS operating profit based on longer-term investment returns is up 15 per cent or £255 million on a CER basis reflecting the continued growth of the in-force book of recurring premium business.

The increase of £6 million in the profit before shareholder tax of asset management operations from £176 million in 2017 to £182 million in 2018 includes an unfavourable exchange translation impact of £5 million. Excluding the currency volatility, profit from Asia asset management operations was up 6 per cent or £11 million on a CER basis, mainly reflecting growth in assets under management, combined with positive operating leverage, offsetting a marginal reduction in revenue margins.

The effective shareholder tax rate on profits from Asia operations increased to 17 per cent in 2018 compared with 12 per cent in 2017, principally due to unrealised investment losses that were not tax deductible.

2017 compared with 2016

The increase of £809 million in insurance operations primarily reflected a favourable movement in non-operating items of £513 million from a non-operating loss of £460 million in 2016 to a non-operating profit of £53 million in 2017 and an increase of adjusted IFRS operating profit based on longer-term investment returns of £296 million from a profit of £1,503 million in 2016 to a profit of £1,799 million in 2017. The favourable change of £513 million in non-operating profit was primarily due to a £227 million one-off remeasurement loss in 2016 attaching to the sold Korea life business and a one-off cumulative exchange gain of £61 million in 2017 recycled from other comprehensive income upon the completion of its disposal, together with the positive change of £224 million in short-term fluctuations in investment returns from a loss of £225 million in 2016 to a loss of £1 million in 2017. The increase of £296 million in adjusted IFRS operating profit based on longer-term investment returns included a positive exchange translation impact of £68 million. Excluding the currency volatility, Asia insurance operations adjusted IFRS operating profit based on longer-term investment returns was up 15 per cent or £228 million, on a CER basis, reflecting the continued growth of the in-force recurring premium business.

The increase of £35 million in asset management operations from £141 million in 2016 to £176 million in 2017 was primarily attributable to an increase in the asset management operation's total assets under management as a result of positive net inflows of assets and favourable market movements, driving higher fee revenues. The increase of £35 million included a positive exchange translation impact of £8 million. Excluding the currency volatility, profit from Asia asset management operations was up 18 per cent on a CER basis.

The effective shareholder tax rate on profits from Asia operations decreased to 12 per cent in 2017 from 22 per cent in 2016, principally due to the inclusion of a non-tax deductible write-down of the sold Korea life business in 2016.

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US

The following table shows the movement in profit arising from US operations and its components (insurance and asset management) for the years indicated.

	Year Ended 31 December £m		
	2018	**2017**	**2016**
Insurance operations	**1,769**	590	529
Asset management	**(30)**	172	(4)
Profit before shareholder tax	**1,739**	762	525
Shareholder tax charge	**(255)**	(508)	66
Profit after tax	**1,484**	254	591

2018 compared with 2017

The increase of £1,230 million in profit after tax from £254 million in 2017 to £1,484 million in 2018 primarily reflects an increase in profit before shareholder tax of £977 million from £762 million to £1,739 million and a decrease in the shareholder tax charge from £508 million to £255 million.

The increase of £977 million in profit before shareholder tax includes an increase of £1,179 million in insurance operations from £590 million to £1,769 million partially offset by a decrease of £202 million in asset management operations from positive £172 million to negative £30 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 increase in the profit before shareholder tax of insurance operations in 2018 compared with 2017 is primarily due to a favourable movement in non-operating items of £1,482 million from negative £1,624 million to negative £142 million. This was partially offset by the decrease of £303 million in adjusted IFRS operating profit based on longer-term investment returns from £2,214 million to £1,911 million. The favourable movement in non-operating items is primarily due to a positive change in short-term fluctuations. In the US, lower equity market levels, alongside higher interest rate levels, resulted in gains on equity hedge instruments which are designed to protect Jackson's capital position, balanced by higher technical reserve requirements.

The decrease of £303 million in adjusted IFRS operating profit based on longer-term investment returns includes a positive translation impact of £77 million. Excluding the currency volatility, adjusted IFRS operating profit based on longer-term investment returns has decreased by £226 million or 11 per cent in 2018 compared with 2017, due to higher fee income that was more than offset by higher market-related DAC amortisation and lower spread-based income. The higher market-related DAC amortisation arises mainly from £194 million acceleration of amortisation compared with £83 million favourable deceleration in 2017 (on a constant exchange rate basis) leading to an adverse year-on-year movement of £277 million. Excluding the acceleration and deceleration in 2018 and 2017, the adjusted IFRS operating profit based on longer-term investment returns would have been 2 per cent higher than 2017 on a constant exchange rate basis. This is further discussed in note C5(b) to the consolidated financial statements.

The £202 million decrease in the loss before shareholder tax of the asset management in 2018 compared with 2017 is reflective of the non-recurrence of a gain recognised in 2017 arising from the disposal of the broker-dealer network and the additional costs incurred in 2018 in exiting from the business.

The effective shareholder tax rate on profits from US operations is 15 per cent in 2018 compared with 67 per cent in 2017, principally due to the inclusion in 2017 of a £445 million one-off charge on the remeasurement of US deferred tax balances following the enactment of a tax reform in December 2017.

2017 compared with 2016

The decrease of £337 million in profit after tax from £591 million in 2016 to £254 million in 2017 primarily reflected an increase in the shareholder tax charge by £574 million from a credit of £66 million in 2016 to a

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charge of £508 million in 2017. This was partly offset by an increase of £237 million in profit before shareholder tax from £525 million in 2016 to £762 million in 2017.

The increase in tax charge in 2017 is primarily attributable to the impact of the US tax reform, which generated a one-off charge of £445 million. The effective tax rate on profits from US operations was 67 per cent in 2017 compared with negative 13 per cent in 2016 primarily driven by this one-off impact.

The increase of £237 million in profit before tax attributable to shareholders included an increase of £61 million in insurance operations from £529 million to £590 million and an increase of £176 million in asset management operations from negative £4 million to positive £172 million in 2017.

The £61 million increase in insurance operations in 2017 compared with 2016 was primarily due to an increase of £162 million in adjusted IFRS operating profit based on longer-term investment returns from £2,052 million in 2016 to £2,214 million in 2017, partially offset by an increase in non-operating loss of £101 million. The increase of £162 million in adjusted IFRS operating profit based on longer-term investment returns included a positive translation impact of £104 million. Excluding the currency volatility, the increase in adjusted IFRS operating profit based on longer-term investment returns in 2017 on a CER basis compared with 2016 was £58 million or 3 per cent, mainly reflecting growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread earnings.

The non-operating loss increased by £101 million from a loss of £1,523 million in 2016 to a loss of £1,624 million in 2017. The increase in non-operating loss was mainly driven by an adverse change in short-term fluctuations in investment returns of £113 million from a loss of £1,455 million in 2016 to a loss of £1,568 million in 2017. The increase of £101 million in non-operating loss included a positive translation impact of £78 million. Excluding the currency volatility, the increase in non-operating loss in 2017 on a CER basis compared with 2016 was £23 million. The negative movement in short-term fluctuations in investment returns was attributable mainly to the net value movement in the period of the hedge instruments held to manage market exposures and reflected the positive equity market performance in the US during the period.

The £176 million increase in asset management operations in 2017 compared with 2016 was primarily due to the gain of £162 million arising from the disposal of the broker-dealer network in August 2017.

UK and Europe

The following table shows the movement in profit arising from the UK and Europe operations and its components (insurance and asset management) for the years indicated.

	Year Ended 31 December £m		
	2018	2017	2016
Insurance operations	**698**	858	1,026
Asset management	**462**	506	433
Profit before shareholder tax	**1,160**	1,364	1,459
Shareholder tax charge	**(216)**	(267)	(275)
Profit after tax	**944**	1,097	1,184

2018 compared with 2017

The decrease of £153 million in the profit after tax from £1,097 million in 2017 to £944 million in 2018 primarily reflects a decrease in the profit before shareholder tax of £204 million from £1,364 million to £1,160 million, partly offset by a decrease of £51 million in the shareholder tax charge from £267 million in 2017 to £216 million in 2018.

The decrease of £204 million in profit before shareholder tax includes a decrease of £160 million in insurance operations from £858 million to £698 million and a decrease of £44 million in asset management operations from £506 million to £462 million.

The UK and Europe's insurance results comprise an annual profit distribution to shareholders from its long-term with-profits funds as well as profit 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.

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For with-profits business (including non-participating business owned by the UK 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 profit for the with-profits business, which is determined on the same basis as on grandfathered UK GAAP, solely reflects one-ninth of the cost of bonuses declared for the year. Further details on the determination of the bonuses ('regular' and 'final') are provided in note C4.2(c) to the consolidated financial statements.

The results of 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 consolidated financial statements.

The decrease in the profit before shareholder tax of the insurance operations of £160 million is mainly driven by an adverse change in non-operating items of £439 million from a loss of a £20 million in 2017 to a loss of £459 million in 2018, primarily reflecting the loss related to the £508 million anticipated pre-tax loss following the reinsurance of UK annuities to Rothesay Life in March 2018. Further details are provided in note D1.1 to the consolidated financial statements. This is partially offset by a £69 million favourable movement in short-term fluctuations in investment returns. Adjusted IFRS operating profit based on longer-term investment returns has increased by £277 million from £861 million in 2017 to £1,138 million in 2018 and principally reflects the benefit from updated longevity assumptions of £441 million together with an 11 per cent increase in shareholder transfer from the with-profits business, which includes a 30 per cent increase in the contribution from PruFund business.

The movement in profit before shareholder tax of the asset management operation from £506 million to £462 million is primarily driven by a decrease in adjusted IFRS operating profit based on longer-term investment returns of £44 million or 9 per cent, largely reflecting a normalisation of performance fees of £15 million, compared with a particularly high contribution of £53 million in the prior year. Excluding the contribution of performance fees, adjusted IFRS operating profit based on longer-term investment returns is 3 per cent higher reflecting both the higher average level of funds managed by M&G (up from £275.9 billion in 2017 to £276.6 billion in 2018) and a higher revenue margin of 40 basis points (2017: 37 basis points) partially offset by charges of £27 million incurred in preparing the business for the UK's proposed exit from the European Union, including the migration of fund assets to our Luxembourg-domiciled SICAV platform.

The effective shareholder tax rate on profits from UK and Europe operations of 19 per cent in 2018 is broadly in line with the effective shareholder tax rate of 20 per cent in 2017.

2017 compared with 2016

The decrease of £87 million in the profit after tax from £1,184 million in 2016 to £1,097 million in 2017 primarily reflected a decrease in the profit before shareholder tax of £95 million from £1,459 million to £1,364 million, partly offset by a decrease of £8 million in the shareholder tax charge from £275 million in 2016 to £267 million in 2017.

The decrease of £95 million in profit before tax attributable to shareholders included a decrease of £168 million in the result for insurance operations from £1,026 million to £858 million, partially offset by an increase of £73 million for asset management operations from £433 million to £506 million.

The decrease in insurance operations of £168 million to £858 million in 2017 was driven by an adverse change in short-term fluctuations in investment returns on shareholder-backed businesses from a profit of £198 million in 2016 to a loss of £20 million in 2017. This was partially offset by an increase in adjusted IFRS operating profit based on longer-term investment returns of £50 million. The £218 million decrease in short-term fluctuations in investment returns included unrealised movements on fixed income assets supporting the capital of the shareholder-backed annuity business that varied differently depending on interest rate and other movements in the profit. Adjusted IFRS operating profit based on longer-term investment returns increased by £50 million from £828 million in 2016 to £878 million in 2017, with contributions from the core[1] with-profits and in-force annuity business stable at £597 million (2016: £601 million). Adjusted IFRS operating profit based on longer-term investment returns included general insurance commission of £17 million in 2017 compared with £29 million in 2016.

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The increase in asset management operations of £73 million to £506 million in 2017 resulted from the positive impacts on earnings of net fund inflows, supportive markets, higher performance fees and costs rising more slowly than income.

The effective shareholder tax rate on profits from UK and Europe operations of 20 per cent in 2017 was broadly in line with the effective shareholder tax rate of 19 per cent in 2016.

Unallocated to a segment

The following table shows the movement in the unallocated to a segment result for the years indicated.

	Year Ended 31 December £m		
	2018	**2017**	**2016**
Loss before shareholder tax	**(901)**	(858)	(893)
Shareholder tax credit	**126**	122	111
Loss after tax	**(775)**	(736)	(782)

2018 compared with 2017

Total net charges for activity unallocated to a segment have increased by £39 million from £736 million 2017 to £775 million in 2018. The loss before shareholder tax increased by £43 million from £858 million in 2017 to £901 million in 2018. The increase primarily reflects higher restructuring costs and costs related to preparation for the previously announced intention to demerge M&GPrudential from Prudential plc, partially offset by a lower interest expense. Restructuring costs includes investment spend in relation to M&GPrudential merger and transformation and efficiency and change programmes across the Group for example the rationalisation of US locations in 2018.

The effective shareholder tax rate on losses unallocated to a segment of 14 per cent in 2018 is in line with the effective shareholder tax rate of 14 per cent in 2017.

2017 compared with 2016

Total net charges for activity unallocated to a segment decreased by £49 million from £782 million in 2016 to £736 million in 2017. The loss before shareholder tax decreased by £35 million from £893 million in 2016 to £858 million in 2017. Other income and expenditure and restructuring costs increased by £189 million from £689 million in 2016 to £878 million in 2017 due to higher interest costs, following the debts issued in 2016 and 2017, and higher restructuring costs as the business invested for the future (including UK and Europe infrastructure). Short-term fluctuations in investment returns showed a favourable movement of £224 million from a loss of £204 million in 2016 to a profit of £20 million in 2017, reflecting the level of unrealised value movements on financial instruments held outside of the main life operations.

The effective tax rate on profits from unallocated to a segment increased to 14 per cent in 2017 from 12 per cent in 2016 principally driven by a decrease in non-tax-deductible expenses increasing the tax credit on the losses from unallocated to a segment.

Basis of Performance Measures

Prudential uses an alternative performance measure of adjusted IFRS 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&GPrudential for the day-to-day management of their business units (within the framework set out in the Group Governance

Manual). Financial management information used by the GEC aligns with these three business segments. These operating segments derive revenue from both long-term insurance and asset management activities.

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

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

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

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

(a) General principles

(i) UK-style with-profits business

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

(ii) Unit-linked business

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

(iii) US variable annuity and fixed index annuity business

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

(iv) Business where policyholder liabilities are sensitive to market conditions

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

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

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

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(v)

Other shareholder-financed business

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

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

Debt securities and loans

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

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

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

At 31 December 2018, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £629 million (2017: £855 million; 2016: £969 million).

Equity-type securities

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

Derivative value movements

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

(b)

Asia insurance operations

(i)

Business where policyholder liabilities are sensitive to market conditions

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

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

(ii)

Other Asia shareholder-financed business

Debt securities

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

Equity-type securities

For Asia insurance operations, investments in equity securities held for non-linked shareholder-backed business amounted to £2,146 million as at 31 December 2018 (31 December 2017: £1,759 million; 31 December 2016: £1,405 million). The rates of return applied in 2018 ranged from 5.3 per cent to 17.6 per cent (2017: 4.3 per cent to 17.2 per cent; 2016: 3.2 per cent to 13.9 per cent) with the rates applied varying by business unit. These rates are broadly stable from period to period but may be different between countries reflecting, for example, differing expectations of inflation in each business unit. The assumptions are for the returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

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

(c) **US insurance operations**

(i) Separate account business

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

(ii) US variable and fixed index annuity business

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

- Fair value movements for equity-based derivatives;
- Fair value movements for guaranteed benefit options for the 'not for life' portion of Guaranteed Minimum Withdrawal Benefit (GMWB) and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance (see below);
- Movements in the accounts carrying value of Guaranteed Minimum Death Benefit (GMDB), GMIB and the 'for life' portion of GMWB liabilities, (see below) for which, under the 'grandfathered' US GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements (ie they are relatively insensitive to the effect of current period equity market and interest rate changes);
- A portion of the fee assessments as well as claim payments, in respect of guarantee liabilities; and
- Related amortisation of deferred acquisition costs for each of the above items.

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

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

Guaranteed benefit option for variable annuity guarantee minimum income benefit

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

(iii) Other derivative value movements

The principal example of non-equity based derivatives (for example, interest rate swaps and swaptions) whose value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns, arises in Jackson. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson's bond portfolio (for which value movements are booked in the statement of other comprehensive income rather than the income statement), product liabilities (for which

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US GAAP accounting as 'grandfathered' under IFRS 4 does not fully reflect the economic features being hedged), and the interest rate exposure attaching to equity-based product options.

(iv)

Other US shareholder-financed business

Debt securities

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

Equity-type securities

As at 31 December 2018, the equity-type securities for US insurance non-separate account operations amounted to £1,359 million (31 December 2017: £946 million; 31 December 2016: £1,323 million). For these operations, the longer-term rates of return for income and capital applied in the years indicated, which reflect the combination of the average risk-free rates over the year and appropriate risk premiums are as follows:

	2018	**2017**	**2016**
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	**6.7% to 7.2%**	6.1% to 6.5%	5.5% to 6.5%
Other equity-type securities such as investments in limited partnerships and private equity funds	**8.7% to 9.2%**	8.1% to 8.5%	7.5% to 8.5%

(d)

UK and Europe insurance operations

(i)

Shareholder-backed annuity business

For this business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the 'adjusted IFRS operating profit based on longer-term investment returns'. Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

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

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

Credit experience compared with assumptions; and

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

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

(ii)

Non-linked shareholder-financed business

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

(e)

Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply and therefore the adjusted IFRS operating profit based on longer-term investment returns is not determined on the

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basis described above. Instead, realised gains and losses are generally included in adjusted IFRS operating profit based on longer-term investment returns with temporary unrealised gains and losses being included in short-term fluctuations. In some instances, realised gains and losses on derivatives and other financial instruments are amortised to adjusted IFRS operating profit based on longer-term investment returns over a time period that reflects the underlying economic substance of the arrangements.

Analysis of adjusted IFRS operating profit based on longer-term investment returns

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

	2018 £m					
	Asia	**US**	**UK and Europe**	**Total segment**	**Unallocated to a segment (other operations)**	**Group total**
Analysis of profit (loss) before tax						
Adjusted IFRS operating profit (loss) based on longer-term investment returns	**2,164**	**1,919**	**1,634**	**5,717**	**(890)**	**4,827**
Short-term fluctuations in investment returns on shareholder-backed business	**(512)**	**(100)**	**34**	**(578)**	**20**	**(558)**
Amortisation of acquisition accounting adjustments	**(4)**	**(42)**	**-**	**(46)**	**-**	**(46)**
Loss on disposal of businesses and corporate transactions	**(11)**	**(38)**	**(508)**	**(557)**	**(31)**	**(588)**
Profit (loss) before tax	**1,637**	**1,739**	**1,160**	**4,536**	**(901)**	**3,635**
Tax attributable to shareholders						**(622)**
Profit for the year						**3,013**

	2017 £m (AER)					
	Asia	**US**	**UK and Europe**	**Total segment**	**Unallocated to a segment (other operations)**	**Group total**
Analysis of profit (loss) before tax						
Adjusted IFRS operating profit (loss) based on longer-term investment returns	1,975	2,224	1,378	5,577	(878)	4,699
Short-term fluctuations in investment returns on shareholder-backed business	(1)	(1,568)	(14)	(1,583)	20	(1,563)
Amortisation of acquisition accounting	(7)	(56)	-	(63)	-	(63)

adjustments						
Gain on disposal of businesses and corporate transactions	61	162	-	223	-	223
Profit (loss) before tax	2,028	762	1,364	4,154	(858)	3,296
Tax attributable to shareholders						(906)
Profit for the year						2,390

	2017* £m (CER)					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Analysis of profit (loss) before tax						
Adjusted IFRS operating profit (loss) based on longer-term investment returns	1,898	2,146	1,378	5,422	(872)	4,550
Short-term fluctuations in investment returns on shareholder-backed business	(7)	(1,513)	(14)	(1,534)	20	(1,514)
Amortisation of acquisition accounting adjustments	(7)	(54)	-	(61)	-	(61)
Gain on disposal of businesses and corporate transactions	61	157	-	218	-	218
Profit (loss) before tax	1,945	736	1,364	4,045	(852)	3,193
Tax attributable to shareholders						(876)
Profit for the year						2,317

	2016 £m (AER)					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Analysis of profit (loss) before tax						
Adjusted IFRS operating profit (loss) based on longer-term investment returns	1,644	2,048	1,253	4,945	(689)	4,256
Short-term fluctuations in investment returns on shareholder-backed business	(225)	(1,455)	206	(1,474)	(204)	(1,678)
Amortisation of acquisition accounting adjustments	(8)	(68)	-	(76)	-	(76)
Loss on disposal of businesses and corporate transactionsnote D1	(227)	-	-	(227)	-	(227)
Profit (loss) before tax	1,184	525	1,459	3,168	(893)	2,275
Tax attributable to shareholders						(354)

Profit for the year	1,921