PRUDENTIAL PLC
Form 20-F
May 16, 2002

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As filed with the Securities and Exchange Commission on May 16, 2002

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2001

Commission File Number: 1-15040

PRUDENTIAL PUBLIC LIMITED COMPANY

(Exact Name of Registrant as Specified in its Charter)

England and Wales
(Jurisdiction of Incorporation)

Laurence Pountney Hill,
London EC4R 0HH, England
(Address of Principal Executive Offices)

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*

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 December 31, 2001 was:

1,993,819,770 Ordinary Shares, 5 pence par value each

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 which financial statement item the registrant has elected to follow:

Item 17 ____ Item 18 _X_

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

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Item 3. Key Information

SELECTED HISTORICAL FINANCIAL INFORMATION OF PRUDENTIAL

The following table sets forth Prudential's selected consolidated financial data for the periods indicated. This data is derived from Prudential's audited consolidated financial statements prepared in accordance with UK GAAP under which insurance business is accounted for on the modified statutory basis (MSB). These accounting principles differ in certain significant respects from US GAAP. The Prudential audited consolidated financial statements included elsewhere in this document include a description of the differences between UK GAAP and US GAAP that are significant to the financial statements. This table is only a summary and you should read it in conjunction with Prudential's consolidated financial statements and the related notes included elsewhere in this document, together with Item 5, "Operating and Financial Review and Prospects".

The profit and loss account and balance sheet data for and as at the years ended December 31, 1997 to 2001 have been derived from Prudential's audited consolidated financial statements and have been restated to reflect accounting policies, principally FRS 19 "Deferred Tax" adopted by Prudential in the year ended December 31, 2001. The consolidated financial statements for the two years ended December 31, 1998 have been audited by PricewaterhouseCoopers, or its predecessor Price Waterhouse, and for the three years ended December 31, 2001 by KPMG

Audit Plc.

	Year Ended December 31,					
	2001[1]	**2001**	**2000[2]**	**1999[2]**	**1998[2]**	**1997[2]**
	(In $ Millions)			**(In £ Millions)**		
Profit and loss account data UK GAAP basis						
Gross premiums from continuing operations including acquisitions:						
Long-term business	**22,110**	**15,196**	14,173	14,826	10,640	9,641
Gross premiums from discontinued operations:						
Long-term business					423	665
General business	**567**	**390**	333	318	310	306
	567	**390**	333	318	733	971
Reinsurance and change in unearned premiums	**(553)**	**(380)**	(130)	(91)	(87)	(72)
Total earned premiums, net of reinsurance	**22,124**	**15,206**	14,376	15,053	11,286	10,540
Investment returns	**(1,798)**	**(1,236)**	5,046	17,232	12,612	12,134
Operating profit before amortization of goodwill and tax[3]						
Continuing operations:						
UK operations	**614**	**422**	438	391	355	383
US operations	**434**	**298**	466	451	411	367
Asian operations	**36**	**25**	36	27	23	20
European operations	**(35)**	**(24)**	(10)	6	4	1
Group activities	**(189)**	**(130)**	(123)	(90)	28	25
UK restructuring	**(60)**	**(41)**		(58)		
Total continuing operations	**800**	**550**	807	727	821	796
Discontinued operations[4]	**105**	**72**	33	49	47	68
Operating profit before amortization of goodwill and tax[5]	**905**	**622**	840	776	868	864
Short term fluctuations in investment returns[6]	**(698)**	**(480)**	(48)	28	24	83
Amortization of goodwill	**(138)**	**(95)**	(84)	(54)		
Merger break fee, net of related expenses	**492**	**338**				
Profit on flotation of Egg and business disposals			239		249	18
Reclassification of shareholder reserves of Australian operation [7]						204
Total profit on ordinary activities before tax	**561**	**385**	947	750	1,141	1,169
Profit after tax:						
Operating profit (including post-tax longer term investment returns)	**669**	**460**	591	507	620	580
Profit for the period (including post-tax actual investment returns)	**566**	**389**	657	472	853	811
Statement of income and comprehensive income data US GAAP						

basis						
Insurance policy revenues	**5,753**	**3,954**	3,614	4,597	3,299	3,040
Investment results	**367**	**252**	4,669	12,793	8,599	10,197
Non-operating income						
Merger break fee, net of related expenses	**492**	**338**				
Profit on Egg flotation			119			
Other income	**901**	**619**	620	600	165	431
Total revenue	**7,513**	**5,163**	9,022	17,990	12,063	13,668
Net (loss) income from continuing operations (after minority interests)	**(437)**	**(300)**	498	869	787	1,070
Net (loss) income from discontinued operations (net of applicable income taxes)	**45**	**31**	4	19	14	12
Cumulative effect of changes in accounting policies	**(202)**	**(139)**				
Total net (loss) income	**(594)**	**(408)**	502	888	801	1,082
Total comprehensive (loss) income	**(99)**	**(68)**	673	431	761	1,233

	At December 31,					
	2001[1]	**2001**	**2000**	**1999**	**1998**	**1997**
	(In $ Millions, Except Share Information)	**(In £ Millions, Except Share Information)**				
Balance sheet data UK GAAP basis						
Total assets	**228,099**	**156,769**	154,950	150,643	118,786	108,223
Long-term business provision	**143,334**	**98,511**	91,006	84,430	76,760	69,512
Technical provision for linked liabilities	**25,874**	**17,783**	18,719	19,043	9,996	10,167
Debenture loans	**3,265**	**2,244**	1,585	1,546	1,031	820
Total shareholders' funds	**5,747**	**3,950**	3,971	3,404	3,298	2,861
Balance sheet data US GAAP basis						
Total assets	**226,497**	**155,668**	153,024	148,922	117,762	108,355
Policyholder benefit liabilities	**122,496**	**84,190**	76,711	71,179	62,878	56,346
Separate account liabilities	**43,256**	**29,729**	32,337	33,477	23,450	22,684
Total shareholders' equity	**8,678**	**5,964**	6,455	6,046	5,997	5,627
Other data						
Long-term business (including investment products)						
New business from continuing operations:						
Single premiums sales	**30,178**	**20,741**	13,354	11,834	7,189	6,780
New regular premiums sales[8]	**1,035**	**711**	569	509	468	487
Total	**31,213**	**21,452**	13,923	12,343	7,657	7,267

	At December 31,						
Funds under management		**237,165**	**163,000**	165,000	170,000	128,300	118,700
Basic earnings per share:							
Based on operating profit from continuing operations before amortization of goodwill and before tax on a UK GAAP basis		**40.4¢**	**27.8p**	41.2p	37.3p	42.3p	41.2p
Based on operating profit before amortization of goodwill and after tax and minority interest on a UK GAAP basis		**33.9¢**	**23.3p**	30.2p	26.0p	31.9p	30.0p
Based on total profit for the financial year after tax on a UK GAAP basis		**28.7¢**	**19.7p**	33.5p	24.2p	43.9p	42.0p
Net (loss) income per share on a US GAAP basis		**(30.0)¢**	**(20.6)p**	25.6p	45.6p	41.4p	56.1p
Diluted (loss) earnings per share UK GAAP		**28.5¢**	**19.6p**	33.4p	24.1p	43.6p	41.7p
Diluted earnings per share US GAAP		**(30.0)¢**	**(20.6)p**	25.5p	45.3p	41.0p	55.8p
Dividend per share(9)		**37.0¢**	**25.4p**	24.5p	23.0p	21.0p	19.1p
Equivalent cents per share(9)(10)			**37.1¢**	35.0¢	36.9¢	34.0¢	31.4¢
Market price at end of period	$	**11.58**	**796.0p**	1,077.0p	1,220.0p	908.0p	734.0p
Share capital		**146**	**100**	99	98	98	97
Number of shares outstanding (in millions)			**1,994**	1,981	1,954	1,949	1,939
Average number of shares (in millions)			**1,978**	1,959	1,947	1,942	1,932

(1) Amounts stated in US dollars have been translated from pounds sterling at the rate of $1.455 per £1.00 (the noon buying rate in New York City on December 31, 2001).

(2) Results for 1997, 1998, 1999 and 2000 have been restated to reflect the adoption of new UK GAAP policies as of December 31, 2001. See Notes 2 and 4 of the notes to Prudential's financial statements for a description of the new policies and the impact of adoption.

(3) Investment returns credited to operating results for investments attributable to shareholders are determined using the longer-term rate of return. For the purposes of determining longer-term investment returns, Jackson National Life averages realized investment gains and losses over five years.

(4) Discontinued operations are restated on an annual basis in order that continuing operations reflect those operations, which form part of the group as at the most recent year-end date.

(5) Due to the long-term nature of Prudential's business, the basis of presentation of operating profit may not be comparable with other UK companies. See Note 5 of the notes to Prudential's consolidated financial statements for a description of the basis.

(6) Short-term fluctuations in investment returns represent the difference between the longer-term return credited to operating profit and the actual investment returns achieved for the year.

(7) Following the introduction of the margin on services basis of financial reporting for Australian life insurers, the allocation between shareholders and policyholders of the life funds of Prudential's Australian operation was clarified by the local supervisory authority. This resulted in a reclassification to shareholders in 1997 of £204 million before tax, which was credited directly to the profit and loss account. Prudential sold its Australian operation in the following year.

(8) New regular business sales are reported above on an annualized basis, which represents a full year of installments in respect of regular premiums irrespective of the actual payments made during the year.

(9) The final dividend with respect to any year is paid in the following year after approval at Prudential's annual general meeting. Final dividends are included in the year to which they relate rather than in the year paid.

(10)

Translated into US dollars at the noon buying rate on the dates each payment is made, apart from the 2001 final dividend due to be paid on May 29, 2002 which has been translated at the rate on May 8, 2002. Annual dividends comprise both interim and final dividend payments. The amounts shown represent the annual dividend accrual rather than the cash payments made in each year.

Dividend Data

Prudential's dividend policy is to increase dividends in line with the underlying growth in earnings of its principal businesses, with due regard for its cash and balance sheet position. Future dividends will depend on Prudential's results of operations, financial condition, cash requirements, future prospects and other factors. Under UK company law, Prudential may pay dividends only if "distributable profits" are available for that purpose. "Distributable profits" are accumulated, realized profits not previously distributed or capitalized less accumulated, realized losses not previously written off. Even if distributable profits are available, Prudential pays dividends only if the amount of its net assets is not less than the aggregate of its called-up share capital and undistributable reserves (such as, for example, the share premium account and the capital redemption reserve) and the payment of the dividend does not reduce the amount of its net assets to less than that aggregate.

As a holding company, Prudential is dependent upon dividends and interest from its subsidiaries to pay cash dividends. Many of its insurance subsidiaries are subject to regulations that restrict the amount of dividends that they can pay to Prudential. These restrictions are discussed in more detail in Item 4, "Information on the Company Supervision and Regulation of Prudential UK Supervision and Regulation Insurance Regulation Distribution of Profits".

Historically, Prudential has declared an interim and a final dividend for each year (with the final dividend being paid in the year following the year to which it relates). Subject to the restrictions set out above, Prudential's directors have the discretion to determine whether to pay a dividend and the amount of any such dividend but must take into account the company's financial position.

Under the UK-US Income Tax Treaty, some US holders of Prudential ordinary shares and ADSs are entitled to a UK tax credit, also called the associated UK tax credit, in respect of a dividend from Prudential equal to the tax credit to which UK resident individuals generally are entitled in respect of the dividend. This UK tax credit, however, is subject to a withholding tax under the UK-US Income Tax Treaty. See Item 10, "Additional Information Taxation UK Taxation of Dividends" for a more detailed description of the withholding tax.

The following table shows certain information regarding the dividends that Prudential paid for the periods indicated in pounds sterling and converted into US dollars at the noon buying rate in effect on each payment date. The final dividend with respect to any calendar year is paid in the following calendar year after approval at Prudential's annual general meeting. Interim dividends for a specific year have generally had a record date in September and a payment date in November of that year, and final dividends have generally had a record date in the following March and a payment date in the following May.

Historical Dividend Information

Year	Interim Dividend per Share	Interim Dividend per Share	Final Dividend Per Share	Final Dividend per Share
	(pence)	(US Dollars)	(pence)	(US Dollars)
1997	6.4	0.10700	12.7	0.20736
1998	7.0	0.11598	14.0	0.22369
1999	7.7	0.12292	15.3	0.24620
2000	8.2	0.11652	16.3	0.23105
2001	8.7	0.12528	16.7	0.24048

Exchange Rate Information

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

Year Ended December 31,	Average

Year Ended December 31,	Average
1997	1.64
1998	1.66
1999	1.61
2000	1.50
2001	1.46

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

	High	Low
November 2001	1.46	1.41
December 2001	1.46	1.42
January 2002	1.46	1.41
February 2002	1.43	1.41
March 2002	1.43	1.41
April 2002	1.46	1.43

On May 15, 2002, the noon buying rate in New York City was £1.00 = $1.46.

Forward-Looking Statements

This annual report contains certain "forward-looking statements". All statements regarding Prudential's future financial condition, results of operations and businesses, strategy, plans and objectives are forward-looking. Statements containing the words "believes", "intends", "expects" and words of similar meaning are also forward-looking. Such statements involve unknown risks, uncertainties and other factors that may cause Prudential's results, performance or achievements or conditions in the markets in which it operates to differ from those expressed or implied in such statements. These factors include regulatory changes, technological development, globalization, levels of spending in major economies, the levels of marketing and promotional expenditures, actions of competitors, employee costs, future exchange and interest rates, changes in tax rates and future business combinations or dispositions, together with other factors discussed in " Risk Factors".

In particular, the following are forward-looking in nature:

- certain statements in Item 4, "Information on the Company" with regard to strategy and management objectives, trends in market shares, prices, market standing and product volumes and the effects of changes or prospective changes in regulation, and

- certain statements in Item 5, "Operating and Financial Review and Prospects" with regard to trends in results, prices, volumes, operations, margins, overall market trends, risk management and exchange rates and with regard to the effects of changes or prospective changes in regulation.

Prudential may also make or disclose written and/or oral forward-looking statements in reports filed or furnished to the US Securities and Exchange Commission, Prudential's annual report and accounts to shareholders, proxy statements, offering circulars, registration statements and prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Prudential to third parties, including financial analysts. Prudential undertakes no obligation to update any of its forward-looking statements.

RISK FACTORS

Prudential's operating results, financial condition and trading price are affected by a number of factors including economic and market conditions, exchange rate fluctuations, regulation, government policy and legislation, competition, credit ratings, and operational systems and processes.

Prudential's businesses are inherently subject to market fluctuations and general economic conditions.

Prudential's businesses are inherently subject to the risks associated with economic and market fluctuations. This is largely because Prudential's shareholders' profit in the United Kingdom is related to bonuses for policyholders declared on its with-profits products, which are broadly based on current rates of returns on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns.

In the United States, fluctuations in prevailing interest rates can affect results from Jackson National Life, which is predominantly a spread-based business with the majority of its assets invested in fixed income securities. In particular, fixed annuities and stable value products expose Jackson National Life to the risk that changes in interest rates which are not fully reflected in the interest rates credited to customers will reduce spread, or the difference between the amounts that it is required to pay under the contracts, and the rate of return it is able to earn on its general account investments to support the obligations under the contract. Declines in spread from these products or other spread business Prudential conducts could have a material impact on its businesses or results of operations.

In all markets in which Prudential operates, its businesses are susceptible to general economic conditions, which can change the level of demand for Prudential's products. The uncertain trends in international economic and investment climates prevailing during 2001 have adversely affected Prudential's business and profitability, principally through reducing investment returns, and may continue to do so unless conditions improve. See Item 5, "Operating and Financial Review and Prospects Factors Affecting Results of Operations General Economic and Market Conditions".

Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its business.

Due to the geographical diversity of Prudential's businesses, it is subject to the risk of exchange rate fluctuations. Prudential's international operations in the United States, Asia and Europe, which represent a significant proportion of total group income and expenses, generally write policies and invest in the same local currency, which although limiting the effect of exchange rate fluctuations on local operating results, can lead to fluctuations in Prudential's consolidated financial statements upon translation of results into pounds sterling. See Item 11,"Quantitative and Qualitative Disclosures about Market Risk".

Prudential's operations are subject to substantial regulation. Changes in the regulatory environments in which Prudential operates could have a negative impact on its reported results.

Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations in the markets in which it operates. Changes in government policy or legislation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates, may adversely affect Prudential's product range and distribution channels and, consequently, reported results. These changes include possible changes in the tax treatment of financial products and services, government pension arrangements and policies, the regulation of selling practices and solvency standards. In addition, potential regulatory changes resulting from the recent Financial Services Authority (FSA) consultation paper on reforming the UK polarization regime and the current Sandler review of with-profits products in the United Kingdom could have a significant effect on the way Prudential's products are priced, distributed and sold. Meanwhile, the introduction by the UK government of stakeholder pensions in April 2001, where charges are capped at 1% of the fund, has had a significant impact on the UK market for pensions. The initiative is beginning to be reflected in the pricing of pension products, as manufacturers are forced to reduce product pricing in response to competitive pressure, potentially reducing revenues and profitability. See Item 5, "Operating and Financial Review and Prospects Factors Affecting Results of Operations Government Policy and Legislation" and Item 4, "Information on the Company Supervision and Regulation of Prudential".

The resolution of several issues affecting the UK financial services industry could have a negative impact on Prudential's reported results or on its relations with current and potential customers.

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the United Kingdom and internationally. Pending legal and regulatory actions include proceedings relating to aspects of Prudential's business and operations which are specific to Prudential and proceedings which are typical of the business it operates, including in the latter case businesses it has closed. Although Prudential believes it has adequately reserved in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such reserves are sufficient. It is possible that Prudential's future performance could be affected by an unfavorable outcome in these matters.

Companies operating in the UK insurance and financial services industries, including Prudential, currently confront a number of regulatory and legal actions, such as the requirement to provide redress to past purchasers of pension policies and regulatory reviews concerning the sale of mortgage endowment products, free standing additional voluntary contributions, or AVCs, and guaranteed annuities. In addition, Prudential is currently discussing the attribution of its inherited estate with the FSA, which may or may not result in a portion of the inherited estate in the main with-profits fund being attributed solely to shareholders. The amount and timing of any attribution to shareholders is sufficiently uncertain that it is not possible to accurately estimate any potential attribution. In addition, it is likely that if any part of the inherited estate is attributed to shareholders, it will remain in Prudential Assurance's long-term fund to support the long-term business and accordingly is unlikely to be distributed to shareholders for some considerable period of time, if at all. See Item 4, "Information on the Company Business of

Prudential Compliance" and " Legal Proceedings".

Prudential's businesses are conducted in highly competitive environments and Prudential's continued profitability depends on its management's ability to respond to these pressures.

The markets for UK, US and Asian financial services are highly competitive, with several factors affecting Prudential's ability to sell its products, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance and historical bonus levels. In some of its markets Prudential faces competitors who are larger, have greater financial resources or a greater market share, offer a broader range of products or who have higher bonus rates or claims-paying ratios.

Prudential believes competition will only intensify in response to consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors. Prudential's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures. See Item 4, "Information on the Company Business of Prudential Competition".

A downgrade in Prudential's financial strength credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties.

Prudential's financial strength credit ratings, which are intended to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in most of Prudential's products, and as a result its competitiveness. Any downgrade in Prudential's ratings could have an adverse effect on its ability to market products and retain current policyholders. In addition, the interest rates Prudential pays on its borrowings are largely dependent on its debt credit ratings, which are in place to measure Prudential's ability to pay its contractual obligations. A ratings downgrade could, depending upon its magnitude, cause these interest rates to increase and cause Prudential's trading counterparties to terminate contractual relations.

Adverse experience in the operational risks inherent in Prudential's business could have a negative impact on its results of operations.

Operational risks are present in all of Prudential's businesses, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, people and systems or from external events. Prudential's business is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. Further, because of the long-term nature of much of Prudential's business, accurate records have to be maintained for significant durations. Prudential's systems and processes are designed to ensure that the operational risks associated with its activities are appropriately controlled, but any weakness in the systems could have a negative impact on its results of operations during the effective period. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk Operational, Compliance and Fiscal Risk" and Item 4, "Business of Prudential UK Business Compliance".

Item 4. Information on the Company

BUSINESS OF PRUDENTIAL

Overview

Prudential is a leading international financial services group, providing retail financial services and fund management in its chosen markets: the United Kingdom, the United States, Asia and continental Europe. At December 31, 2001, Prudential was one of the 20 largest public companies in the United Kingdom in terms of market capitalization on the London Stock Exchange. Prudential is not affiliated with Prudential Insurance Company of America.

Prudential has been writing life insurance in the United Kingdom for over 150 years and has had the largest long-term fund in the United Kingdom for over a century. Prudential began writing property and casualty insurance in 1915, and expanded its business into British Commonwealth countries, including Singapore and Malaysia, in the 1920s and 1930s. In 1986, Prudential acquired Jackson National Life Insurance Company, a US insurance company writing life and fixed annuity business. In 1996, Prudential established its direct banking operations. In 1998, Prudential launched Egg, a leading e-commerce retail financial services provider, and in 1999, Prudential acquired M&G, a leading UK fund manager. In June 2000, Prudential completed its listing on the New York Stock Exchange and completed an initial public offering of Egg plc on the London Stock Exchange.

In the United Kingdom, Prudential offers a range of retail financial products and services, including long-term insurance and asset accumulation products (life insurance, pensions and pensions annuities), retail investment and unit trust products, fund management services and banking products. Prudential primarily distributes these products through independent financial advisers, referred to as IFAs, and direct marketing, by telephone, mail and the internet.

At December 31, 2001, in the United Kingdom, Prudential was:

- the second-largest life insurance company in terms of market capitalization,
- the proprietor of the largest long-term fund of investment assets supporting long-term insurance products,
- the second-largest retail fund manager in terms of funds under management,
- a leading e-commerce retail financial services provider, and
- rated AAA "extremely strong" by Standard & Poor's and Aaa by Moody's in terms of financial strength rating for Prudential Assurance's long-term fund. Prudential is one of only eleven insurance companies worldwide with AAA financial strength ratings from both Standard and Poor's and Moody's.

In the United States, Prudential offers a range of products through Jackson National Life Insurance Company, including fixed, equity-indexed and variable annuities, life insurance, guaranteed investment contracts and funding agreements. Prudential distributes these products through independent insurance agents, securities broker-dealers and banks, credit unions and other financial institutions. At December 31, 2001, in the United States, Jackson National Life was:

- the tenth-largest life insurance company in terms of General Account assets,
- the fifth-largest provider of individual fixed annuities in terms of sales,
- the fifth-largest provider of equity-indexed annuities in terms of sales,
- a top ten provider of stable value products in terms of in-force liabilities, and
- rated AAA by Standard & Poor's, AA+ by Fitch Ratings and A+ by A.M. Best Co. in terms of financial strength rating.

In Asia, Prudential has operations in 12 countries and offers life insurance with health insurance options, personal lines property and casualty insurance and investment products, which it tailors to suit the local markets. Prudential distributes these products primarily through its agency salesforces and through bancassurance arrangements. Alongside its wholly owned operations in Asia, Prudential has forged successful joint ventures with some of the region's leading financial institutions including CITIC (China International Trust and Investment Corporation), Bank of China International, India's ICICI and Standard Chartered Bank.

At December 31, 2001, in Asia, Prudential was:

- the second-largest life insurance company in Singapore, in terms of new regular premium business,
- the second-largest life insurance company in Malaysia, in terms of new regular premium business, and
- the third-largest life insurance company in Hong Kong, in terms of new regular premium business.

In its European business segment, Prudential currently offers life insurance and pensions in Germany and a single premium savings product in France. Prudential has also entered into non-exclusive strategic distribution arrangements with leading local distributors in both France and Germany.

Prudential's operating profit under UK GAAP before amortization of goodwill and tax for the periods indicated is set forth in the table below.

	Year Ended December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
UK Insurance Operations	**435**	468	454
M&G	**75**	125	87
Egg	**(88)**	(155)	(150)
Total UK operations	**422**	438	391
US operations	**298**	466	451
Asian operations	**25**	36	27
European operations	**(24)**	(10)	6
Group activities	**(130)**	(123)	(90)
UK restructuring	**(41)**		(58)
Continuing operations	**550**	807	727
Discontinued operations			
Personal lines property and casualty insurance	**79**	33	61
Restructuring	**(7)**		(12)
Total discontinued operations	**72**	33	49
Total operating profit before amortization of goodwill and tax(1)	**622**	840	776

(1) For the purpose of this annual report, operating profit is determined on a long-term investment return basis and before amortization of goodwill, the American General merger break fee and profit on business disposals.

Strategy

Shareholder Focus

Prudential's commitment to its shareholders is to maximize the value over time of their investment. Prudential has a clear focus on managing for value, which drives how it sets its strategic goals, monitors business performance and incentivizes and rewards management. As part of this ambition Prudential has set a goal for the next four years of doubling the intrinsic value of the group.

With respect to Prudential's insurance operations, this translates into the approximate doubling of new business achieved profits (a widely accepted alternative profit measure in the United Kingdom which shows the current value of future cashflows to shareholders of new business, as discussed in "Item 5 Operating and Financial Review and Prospects Achieved Profits Basis of Reporting"). For Prudential's non-insurance operations, doubling of intrinsic value can be assessed based on a fair value measurement, which for Egg could be doubling of market capitalization, whereas for M&G could be assessed on doubling of operating profit.

This goal has been set for the group as a whole. Prudential expects its constituent businesses to double value at different rates over the four year period, with some, such as Egg or Prudential's Asian operations, expected to achieve this goal in less than four years, whereas for others delivery may take longer. Prudential does not expect overall group growth rates to be the same in every year. The key to Prudential achieving this target will be performance delivery, including Prudential's ability to develop the business so that growth will continue after the four year period while continuing to deliver value.

Building the Platform

In recent years, the global retail financial services industry has undergone significant change. Changes in underlying demographics, government attitudes, technology and customer demands are all driving fundamental change in the industry. Prudential is determined to deliver superior returns to its shareholders and has therefore fundamentally reconfigured its business to compete more effectively in this changing environment.

Over the past five years, Prudential has transformed itself from a business with a narrow product range and limited distribution channel focus to a multi-channel, multi-brand business with a broad product range and a clear retail financial services focus. At the same time, Prudential has withdrawn from those operations or markets that did not meet its target returns or that did not offer the opportunities to achieve critical mass.

Prudential has significantly restructured its traditional insurance operations in both the United Kingdom and the United States to improve its customer focus and management accountability, and to broaden its product range and distribution reach. In the United Kingdom, Prudential has restructured this business into a single integrated business combining Prudential's UK businesses with Scottish Amicable's, which were acquired in 1997, to form Prudential UK Insurance Operations. The new simplified organizational structure combines the previous three UK insurance divisions (Prudential Financial Services, Prudential Insurance Services and Prudential Intermediary Business, which included Scottish Amicable) into Prudential UK Insurance Operations, effective January 1, 2002. Prudential anticipates that this will improve operational effectiveness by removing duplication and that greater customer focus will be achieved by providing a seamless service from product manufacture to distribution. Meanwhile, Egg has added banking products to Prudential's product range and is in a market leading position to provide on-line financial products.

In the United States, Prudential has significantly diversified its product range and distribution strategy. Prudential has launched and developed its own equity-based, index-linked and stable value product ranges complementing its fixed annuity products, successfully entered the broker-dealer market and significantly grown its presence in the bank channel reflecting Prudential's initiative to expand its distribution capabilities.

In Asia, Prudential has expanded its operations from three countries six years ago to twelve today through a combination of acquisitions, joint ventures and organic initiatives. Prudential has made considerable progress in both growing its more established markets of Hong Kong, Singapore and Malaysia, and establishing itself in its newer markets including India, Taiwan, Vietnam, China, Japan and South Korea. Prudential is now in a strong position to capture a major part of the region's fast-growing financial services market.

The cost of development initiatives has adversely impacted, and will continue to adversely impact, short-term earnings, but Prudential believes that each of these investments is building long-term shareholder value. This value is clearly demonstrated by the scale and mix of Prudential's new business sales. In 2001, new business inflows exceeded £21.4 billion with over 46% coming from mutual fund sales, and over 68% coming from outside the United Kingdom.

This transformation has created a strong platform to pursue strategic initiatives for future growth and shareholder value creation.

Growing the Business

Prudential is conscious that the retail financial services industry continues to change, and it expects to continue to adapt its business to build a strong advantage over its competitors and to deliver superior returns to shareholders. Prudential will pursue its key strategic themes of maintaining focus on its customers, investing in technology to improve further customer access and service, driving down costs and driving growth in new and expanding markets. In furtherance of these themes, Prudential has already restructured its UK intermediary distribution channel to become more customer focused, continued Egg's on-line presence, restructured its UK operations to lower costs and entered new life insurance markets in Japan and South Korea.

The listing of Prudential on the New York Stock Exchange in June 2000 reflects the increasingly international nature of Prudential's business and has enabled it to widen its international shareholder base.

The initial public offering of a minority stake in Egg in June 2000 was an important step towards ensuring that Prudential realizes the full potential of this business. This independent quotation is designed to provide Egg with the ability to grow and expand with its own acquisition currency and to enhance its ability to recruit, retain and incentivize staff. Prudential intends to continue investing in all of its businesses to ensure it retains its market-leading positions.

Driving Growth in New and Expanding Markets

Within its existing major markets of the United Kingdom, the United States and Asia, Prudential believes fundamental shifts in demographics and in pension provision will create significant opportunities for future profitable growth.

At the same time as pursuing growth in its existing markets, Prudential continues to seek new markets in which it believes it can create value for its shareholders. Prudential's strategy for continental Europe involves harnessing its equity-based product expertise and tailoring it for individual European markets. Prudential plans to distribute its products through a series of non-exclusive strategic partnerships with leading local financial service providers, initially focusing on the four most populous markets of France, Germany, Spain and Italy.

In February 2002, M&G announced the launch of M&G International, focused initially on the distribution of M&G branded mutual funds to institutional investors in Germany and Austria. M&G International is also developing plans for institutional business in Italy and Luxembourg and the retail markets of Germany and Austria.

Prudential believes that Asia offers significant opportunities for growth. During 2000 and 2001, Prudential made considerable progress in establishing itself in new markets in Asia. In China, Prudential received a license to write life assurance business in the city of Guangzhou and commenced operations there in the last quarter of 2000. Prudential anticipates obtaining licenses for other cities in China. In Hong Kong, Prudential formed a joint venture with the Bank of China International to target the compulsory Mandatory Provident Fund market.

In February 2001, Prudential commenced writing life insurance business in Japan following its acquisition of Orico Life. In November 2001, Prudential commenced writing life insurance in South Korea following its acquisition of YoungPoong Life.

In India, Prudential has successfully entered the mutual fund market in a venture with The Industrial Credit and Investment Corporation of India Limited ("ICICI") and has re-established the Prudential brand in India. Following the liberalization of the Indian life insurance market in 2000, ICICI Prudential Life Insurance, Prudential's joint venture with ICICI, received a life insurance licence in India providing Prudential with the opportunity to target the world's second largest population. 2001 marked the first full year of sales for ICICI Prudential Life Insurance.

The success of Prudential's mutual fund operation in India encouraged it to initiate the development of similar offerings across Asia and in October 2000, Prudential acquired an 89% interest in Prudential SITE in Taiwan. This provides Prudential with potentially significant opportunities to accelerate its growth and profits from the Asian market.

Prudential continues to consider opportunities to acquire businesses to further the strategy of growing its business, particularly in new and expanding markets. Prudential may finance these acquisitions with bank borrowings, debt or equity issuances or a combination of such financings.

Focusing on Customers

Prudential's goal is to deliver the products that its customers want, through the distribution channels they wish to use. Prudential is continually exploring opportunities to expand its distribution reach and broaden its product offering.

In the United Kingdom, Prudential has complementary businesses and market-leading positions in key product areas, enabling it to deliver sustained growth in the low margin environment in which it now operates. The businesses comprising Prudential's UK Insurance Operations have undergone enormous transformations in recent years. The development of Prudential's business model to improve its service to over seven million customers continued in 2001. To bring together several operating units under the powerful Prudential brand, a more focused strategic direction for the UK business has been developed. In achieving this Prudential closed its direct sales channels, improved customer service operations and created further cost efficiencies.

M&G's market position, investment capabilities and brand strength make it one of the leading fund managers in the United Kingdom. Meanwhile, the successful integration with Prudential Portfolio Managers has created a focused business with strong positions in all of its markets.

During the year, Egg acquired 600,000 net new customers, giving it a total of 1.95 million customers at December 31, 2001. At the end of March 2002, Egg had over two million customers. Its credit card business performed strongly in 2001, particularly Egg Card, which had 1.37 million customers at December 31, 2001.

In the United States, Prudential, through Jackson National Life, is one of the few providers to have a significant market position across the range of fixed, variable and equity-indexed annuity products. It also offers life and stable value products. Jackson National Life has expanded its distribution channels to include independent agents, broker-dealers and banks and other financial institutions. Prudential will continue to seek opportunities to expand its product range and distribution capability in the United States, both through acquisitions and organic initiatives, and its exposure to equity-based products, including variable annuities and mutual funds.

Across Asia, Prudential is a market leader in developing innovative savings and insurance products. It has leveraged its UK and US product expertise and proactively worked with Asian regulators to bring new products to market. Prudential has offered mutual fund products in India since 1998, and at December 31, 2001 had £1,071 million of funds under management. Building on its initiatives in India and Taiwan, where it has £1,967 million funds under management, Prudential intends to develop mutual fund offerings in other Asian countries. Prudential is also working to create a multi-channel distribution capability across the region. In addition to its core agency distribution channel, Prudential has established bancassurance relationships with leading banks in Singapore, Hong Kong, Malaysia, China, India, Taiwan, Indonesia, Thailand and Vietnam.

Investing in Technology

Prudential believes that technology is a key enabler in its industry in both driving efficiency through lower costs of administration and as a major distribution channel across the group. Prudential is investing in technology because it believes technology to be a source of considerable competitive advantage.

The development of Egg is the most visible and high profile example of Prudential's investment in technology. Prudential believes that Egg has developed significant first-mover advantage in the e-commerce retail financial services market in the United Kingdom. Egg is, however, just one example of a number of developments Prudential has underway. All of Prudential's businesses are rapidly progressing in making e-commerce integral to the way the group does business.

Summary

Prudential's strategic initiatives over the past few years have significantly changed the shape and focus of its group and have built a platform for further growth and value generation. Prudential believes that by continuing to implement its strategy of product innovation for the benefit of its customers, continuing to invest in technology to drive growth in its newer markets, improve efficiency and develop new distribution channels, it will maximize value for its shareholders both now and over the long term.

Significant Subsidiaries

The table below sets forth Prudential's significant subsidiaries.

Name of Company	Percentage Owned(1)	Country of Incorporation
Egg Banking plc(2)(3) (previously Prudential Banking plc)	79%	England and Wales
Jackson National Life Insurance Company(2)	100%	United States
M&G Investment Management Limited(2)	100%	England and Wales
Prudential Annuities Limited(2)	100%	England and Wales
The Prudential Assurance Company Limited	100%	England and Wales
Prudential Assurance Company Singapore (Pte) Limited(2)	100%	Singapore
Prudential Retirement Income Limited(2)	100%	Scotland
Scottish Amicable Life plc(2)	100%	Scotland

(1) Percentage of equity owned by Prudential directly or indirectly. The percentage of voting power held is the same as the percentage owned.

(2) Owned by a subsidiary of Prudential.

(3)

Egg Banking plc is a wholly-owned subsidiary of Egg plc, a listed subsidiary of Prudential. Following its initial public offering of approximately 21% of the shares of Egg plc in June 2000, Prudential owns approximately 79% of Egg plc.

UK Business

Introduction

Prudential's UK business is structured into business units, each focusing on its respective target customer markets. Prudential's UK business units are UK Insurance Operations, M&G, and Egg.

The following discussion describes:

- the UK retail financial services market,
- Prudential's UK business units and products,
- Prudential's reinsurance arrangements and reserving practices,
- shareholders' participation in Prudential's long-term insurance business, and
- other matters, including pensions misselling, other general compliance matters and restructuring.

In 2001, Prudential's UK business generated operating profit from continuing operations before amortization of goodwill and tax of £422 million and total UK new business insurance premiums of £5,685 million. As of December 31, 2001 M&G had £120 billion funds under management. Meanwhile, as at December 31, 2001 Egg had deposits of £5,945 million, a mortgage book of £2,427 million and a credit card book of £1,769 million.

UK Retail Financial Services Market Overview

The United Kingdom is the world's third-largest life insurance market in terms of premiums and is one of the largest retail banking markets. In recent years, the UK insurance and banking markets have changed significantly and are continuing to evolve as a result of changes in regulation and government policy, demographics, technological development and consumer awareness and attitudes. Retail financial services providers are adapting to these changes by broadening the range of products that they offer and the means by which those products are distributed to and accessed by customers.

The historical divisions between insurance, banking and other financial products have been eroded. It is increasingly common for providers to offer a range of pension products, life products and services, property and casualty insurance, banking products and retail investment products and services. Consumers are increasingly being offered access to these products through direct marketing and e-commerce, as well as through the traditional company salesforce, independent financial advisors, or IFAs, and bank branch distribution channels.

New entrants to the retail financial services market have capitalized on the relatively simple nature of many savings, investment, property and casualty insurance and banking products designed for direct distribution channels and used their established retail brands and advanced technology to market these products. New entrants are also taking advantage of the lower cost barriers to entry afforded by internet distribution, especially in the area of retail banking.

Competition among retail financial service companies is focused on product range, distribution reach, brand, investment performance, specific benefits offered by products, charges and financial strength.

Products

The traditional life insurance product offered by UK life insurance companies was a long-term savings product with a life insurance component. The life insurance element conferred tax advantages that distinguished the traditional life insurance products offered in the United Kingdom from the savings products offered by banks, building societies and unit trust companies. The gradual reduction of these tax advantages and increasing sales of single premium life products have resulted in the distinction between life insurance and other long-term savings products becoming less important. Pension products remain tax-advantaged within certain limits.

Demand for private personal pension and savings products has increased during recent years, in part reflecting a change in the UK government's approach to social security that has encouraged long-term savings through tax advantages, but also in reaction to the growing realization that state-provided pensions are unlikely to provide sufficient retirement income. An ageing population is focusing on asset-accumulation and other retirement products to supplement their state benefits, while younger generations are focusing on pension and long-term savings products as well as health and income protection cover.

During the late 1980s, the UK government began encouraging individuals to invest in equities, with particular emphasis on UK equities. The UK government's privatization program and the introduction of tax-advantaged Personal Equity Plans, referred to as PEPs, in 1988 have considerably widened the UK equity investor base. The current UK government replaced PEPs in April 1999 with Individual Savings Accounts, referred to as ISAs, a new tax-advantaged product that offers equity, insurance and deposit investment options.

The UK government introduced "stakeholder pensions" in April 2001 with the intention of creating a pension for individuals identified as earning enough to be able to afford to make a contribution towards a pension but who are not currently doing so.

A new financial reporting standard, FRS 17 "Retirement Benefits", was introduced in November 2000, applying to all companies that report under UK GAAP. When fully implemented in 2003, the standard will require that companies include the whole of any pension surplus or deficit of defined benefit schemes in their balance sheet and has changed the way in which pension surpluses and deficits are valued. As a result many companies are expecting to change their pension arrangements to defined contribution schemes, an area in which Prudential has a strong offering, and to produce a significant growth in bulk annuities, a market in which Prudential has a significant market share.

With-Profits Products

The majority of the life and pensions business traditionally written in the United Kingdom is with-profits business. For a detailed description of Prudential's with-profits products and policies, see Item 4, " Shareholders' Interests in Prudential's Long-term Insurance Business With-profits Products".

Distribution

Retail financial services and products are distributed face-to-face, through branches, tied agents, company salesforces and IFAs, or directly by mail, telephone and over the internet. Tied agents are exclusive agents who represent only one insurer and must offer customers the products most suitable to their needs, but only from the range of products offered by that insurer. In recent years the high costs of company salesforces and tied agency networks, combined with customers perceiving a lack of choice, has meant that salesforces and tied agents have lost significant market share to IFAs, with the result that many insurers, including Prudential, have chosen to close these tied agents and direct salesforce networks.

Increasingly, consumers require access that is compatible with their lifestyle. IFAs, banks, direct marketing and e-commerce distribution are gaining market share at the expense of traditional company salesforces. Direct and e-commerce distribution methods are generally lower-cost than other methods but have not been conducive to providing financial advice to the consumer to date. Accordingly, products distributed directly are generally more straightforward and have lower, often fee-based, charges. Although the e-commerce market is still small, it is expanding rapidly and Prudential believes it has considerable potential for further growth.

IFAs are required by the UK polarization laws to provide the best advice to customers, considering all of the products available in the market and the customer's particular circumstances, and are legally responsible for their own advice. In contrast, while company salesforces may only sell the products of the company of which they are employed, they must nevertheless also provide the best advice concerning the products offered by their company in the light of the customer's particular circumstances. A company has legal responsibility for the advice its salesforce provides and the conduct of its tied agents.

The FSA announced the relaxation of these polarization rules in March 2001 with respect to stakeholder pension schemes and direct offer financial promotions for packaged products (which include life policies other than pure protection policies, pensions, regulated collective investment schemes and investment trust savings schemes). As a result of these changes, tied sales forces and appointed representatives of product provider firms are now free to market stakeholder pensions manufactured by any other company.

Further relaxation of the polarization rules is expected following the publication in January 2002 of FSA Consultation Paper 121, "Reforming Polarization: Making the Market Work for Consumers", in which the FSA makes a number of proposals for the reform of polarization which, if adopted, would fundamentally alter the relationship between product manufacturers and distributors. See Item 4, "Business of Prudential Supervision and Regulation of Prudential UK Supervision and Regulation FSA Conduct of Business Rules".

UK Business Units

UK Insurance Operations

In 2001, operating profit before taxation and restructuring from Prudential's long-term UK Insurance Operations was £435 million. This represented 87% of the total £501 million operating profit before taxation and restructuring recorded by Prudential in the United Kingdom from long-term and other operations, including £79 million from its discontinued personal lines property and casualty business. See " UK Business Personal Lines Property and Casualty Insurance Products Transfer of Business to Winterthur".

Products

Prudential offers a wide range of products, which are marketed under the "Prudential" and "Scottish Amicable" brands. After June 2002, products will only be sold under the Prudential brand. See " UK Restructurings". The products distributed include long-term products consisting of:

- life insurance savings-type products and pure protection products,
- individual and corporate pensions, and
- pension annuities.

Until December 2001, Prudential also offered personal lines property and casualty insurance through its UK Insurance Operations. However it transferred this business in January 2002 to Winterthur Insurance and the Churchill group, Winterthur's UK subsidiary. See " Personal Lines Property and Casualty Insurance Products Transfer of Business to Winterthur".

Long Term Products

Prudential's long-term products in the United Kingdom consist of life insurance, pension products and pensions annuities. The following table shows Prudential's UK Insurance Operations 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.

	Year Ended December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
Life insurance			
With-profits	**2,222**	2,047	2,938
Unit-linked	**339**	212	126
Other			5
Total life insurance	**2,561**	2,259	3,069
Pensions			
With-profits individual	**153**	181	172
Unit-linked individual	**186**	163	122
DSS rebates	**249**	234	239
Corporate	**701**	953	731
Total pensions	**1,289**	1,531	1,264
Pensions annuities			
Fixed	**1,704**	1,097	2,184
With-profits	**131**	157	155

	Year Ended December 31,		
Total pensions annuities	**1,835**	1,254	2,339
	5,685	5,044	6,672
Investment products	**91**	159	99
Total new business premiums	**5,776**	5,203	6,771

Of total premiums of £5,776 million in 2001, £4,784 million were sold through IFAs, an increase of 24% from the £3,854 million of sales through this channel in 2000. Due to the closure of Prudential's direct sales force, announced in February 2001, sales through this channel, excluding internal vestings from Prudential-branded pension products, fell from £896 million in 2000 to £504 million in 2001.

Life Insurance Products

Prudential's UK life insurance products are predominantly medium to long-term savings products with life cover attached, and also include whole life products and pure protection (term) products. The savings products Prudential offers include investment bonds and endowment plans. Each of these products provides a death benefit in addition to the savings feature.

Savings Products Investment Bonds

Prudential's investment bonds are single premium products that may be with-profits or unit-linked products, although the with-profits products represent the vast majority of its new business premiums.

The Prudence Bond, a single premium, unitized with-profits policy with no fixed term, is one of the United Kingdom's leading investment bond products. In 2001, total new business premiums attributable to the Prudence Bond and to the Prudential Investment Bond, a similar product, were in excess of £2 billion.

These products aim to provide capital growth over the medium to long-term, access to this capital growth, and access to different investment areas without the risks associated with direct investment into these areas. Capital growth for the policyholder on with-profits bonds is achieved by the addition of reversionary or regular bonuses, both of which are credited to the bond on a daily basis from investment returns achieved within the long-term fund of Prudential Assurance with-profits fund. A terminal bonus may also be added when the bond is surrendered. Capital growth on unit-linked bonds is achieved by the movement of the assets underlying those funds.

Savings Products Endowment Plans

Endowment plans are long-term regular premium with-profits or unit-linked savings products that are designed to provide a lump sum at the end of a fixed term and death cover during the term. Endowment products were used in the United Kingdom to provide a lump sum for mortgage repayment with the borrower taking out an endowment assurance policy for the same term as the mortgage loan. In April 2001, Prudential announced that, due to the shift within the marketplace towards repayment mortgages over the past few years, and the consequent significant fall in demand for endowment products, Scottish Amicable, its sole provider of mortgage endowments, would withdraw from the mortgage endowment market.

Pension Products

Prudential provides both individual and corporate pension products. In 2001, new business premiums totaled £339 million for individual pensions and £701 million for corporate pensions. Pension products are tax-advantaged long-term savings products that comply with rules established by the UK Inland Revenue and are designed to supplement state-provided pensions. These rules require that, upon retirement, maturity benefits are used to purchase pension annuities, although they do permit a limited amount to be taken as a tax-free lump sum. These products typically have minimal mortality risk and are primarily considered investment products.

Many of the pension products Prudential offers are with-profits products or offer the option to have all or part of the contributions allocated to a with-profits fund. Where funds invested in the with-profits fund are withdrawn prior to the pension date specified by the policyholder, Prudential may apply a market value adjustment to the amount paid out. The remaining pension products are non-participating products, which include unit-linked products.

Individual Pensions

Prudential's individual pension products include personal pension plans and free standing additional voluntary contribution products. Prudential's free standing additional voluntary contribution plans permit individuals to supplement the pension benefits they accumulate in their occupational pension plan. Both of these products are either unit-linked or unitized with-profits products or contain options to permit premiums to be paid into a unitized with-profits fund.

In addition, Prudential has recently introduced products that meet the criteria of the UK government's stakeholder pension program. The stakeholder pension is intended for individuals earning enough to be able to afford to make contributions to a pension but who are not currently doing so. The introduction of stakeholder pensions has implications, for among other things, how Prudential designs, administers, charges for and distributes pension products. The most significant requirements involve capping of charges and establishing a minimum acceptable contribution. The government has capped charges at 1% of the policyholder account balance per annum for stakeholder pensions, which is significantly below the charges on personal pension products previously charged by the UK pensions industry.

Department of Social Security Rebates

Prudential also provides individual personal pension products through the "DSS Rebate" arrangement. Under this arrangement, individuals may elect to contract out of the UK's State Earnings Related Pension Scheme administered by the UK Department of Social Security. If an individual elects to contract out, then he or she will designate a pensions provider, such as Prudential, with which he or she would like to have a pension product. Premiums on the product are met through "rebates" from the Department of Social Security, which represent the amount that would be otherwise paid into the state pension scheme. Rebate amounts are invested to provide benefits to the individual. Premiums from Department of Social Security rebates are typically reported in the first quarter of each year. In 2001, Prudential received total premiums of £249 million from Department of Social Security rebates.

Corporate Pensions

There are two categories of corporate pension products: defined benefit and defined contribution. Prudential has an established defined benefit plan client base that ranges from small unlisted companies to some of the largest companies in the United Kingdom.

UK regulations require that all companies that offer a defined benefit pension plan must also offer a group additional voluntary contribution plan to their employees. Additional voluntary contribution plans enable employees to make additional pension payments, either regularly or as a lump sum, to supplement their occupational pension plans. Prudential's additional voluntary contribution business is the second largest in the United Kingdom in terms of premium income.

Defined benefit plans and products continue to dominate the corporate pensions market in terms of funds under management. In recent years most new plans established have been defined contribution products. The products Prudential offers to the corporate pensions market are group unit-linked policies and with-profits deposit administration policies. Prudential's defined contribution products are additional voluntary contribution plans, money purchase plans, grouped personal pension plans, self-invested personal pension plans and executive pension plans.

Pension Annuities

Prudential offers immediate annuities that are either fixed annuities, where annuity payments are guaranteed from the outset, or with-profits annuities. Prudential also offers bulk annuities, whereby it manages the assets of a company pension scheme, usually when they are in the process of winding up. Due to the nature of the product, the volume of Prudential's bulk annuity sales is unpredictable. In 2001, Prudential sold £575 million of bulk annuities. Internal vestings represented 38% of Prudential-branded annuity sales.

Prudential's immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump-sum capital payment. No surrender value is available under any of these products. The primary risk to Prudential from fixed annuity products, therefore, is mortality risk. During 2001 Prudential launched an innovative flexible retirement income annuity, FRIA, and an impaired life annuity. Prudential is hoping to build on this initial success in 2002.

Fixed Annuities

Prudential offers three types of fixed annuities: level, fixed-increase and index-linked. The level annuity offered provides a fixed amount of income for the specified term. Prudential's fixed-increase annuity incorporates automatic increases by fixed amounts over the specified period. The index-linked annuities Prudential offers provide for a regular payment to which an additional amount based on the increase in the UK Retail Prices Index is added periodically. In 2001, sales of fixed annuities were £1,704 million.

With-profits Annuities

Prudential is one of only a few companies in the United Kingdom writing with-profits annuities. In 2001, Prudential wrote £131 million of this business. Prudential's with-profits annuities combine the income features of annuity products with the smoothing feature of with-profits products and enable policyholders to obtain equity-type returns. Policyholders select an "anticipated bonus" from the specific range Prudential offers for the particular product. The value of the annuity payment each year depends upon the anticipated bonus rate selected by the policyholder when the product is purchased and the bonuses Prudential declares each year during the term of the product. If bonus rates fall below the anticipated rate then the annuity income falls.

Personal Lines Property and Casualty Insurance Products

Prudential's personal lines property and casualty insurance products in the United Kingdom were primarily household and motor insurance for individuals, referred to as personal lines. Prudential offered its personal lines products primarily through direct marketing and in connection with its banking business. Home insurance gross premiums of £307 million in 2001 accounted for 79% of Prudential's personal lines property and casualty premiums. Prudential's motor policies provided coverage to individuals for third-party liability, including property damage and bodily injury, theft, fire and collision damage.

The following table shows gross premiums for Prudential's UK personal lines property and casualty insurance products for the periods indicated.

	Year Ended December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
Home	**307**	276	274
Motor insurance	**83**	57	44
Total	**390**	333	318

Transfer of Business to Winterthur

In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance business to Winterthur Insurance and the Churchill Group, its UK subsidiary. On December 31, the insurance liabilities were almost wholly reassured, to Winterthur Insurance. The related cash transfer for this reinsurance was offset in January 2002 against the sales proceeds of this business. The sale was completed on January 4, 2002 for a consideration of £353 million. After allowing for the costs of the sale and other related items it is anticipated that profit on sale recorded in the 2002 results will be approximately £360 million before tax. In addition Prudential anticipates the release of approximately £200 million of solvency capital and approximately £21 million of net profits in the unearned premium reserve, and receiving £236 million in relation to the conservatively estimated net present value of future commissions and profits over the term of the agreement. This alliance with Churchill is part of Prudential's UK strategy to focus on core medium and long-term saving businesses, and will see Churchill offering Prudential branded products in the United Kingdom.

Profits from Prudential's UK personal lines property and casualty products have been classified as discontinued operations for 2001.

Closed Business

Prior to 1993, Prudential wrote a wide range of property and casualty insurance business, including commercial cover, which it sold through brokers and its company salesforce. Prudential also had a London Market operation and specialist marine and aviation insurance operations. Prudential had withdrawn from all of these areas by the end of 1993 and, consequently, these businesses are now in run-off. The total claims provisions established for these closed businesses amounted to £144 million at December 31, 2001. Prudential believes these provisions are prudent and does not currently anticipate that it will need to make any further provisions in respect of these closed businesses.

UK Restructurings

In February 2001, Prudential announced the restructuring of the direct salesforce and customer service channels of its UK Insurance Operations. In November 2001, Prudential announced further details of changes to the future structure of those operations, in particular the intention to pursue a single brand strategy for life and pensions business including the integration of its Scottish Amicable operations under the Prudential brand. The changes also included a simplification of the organizational structure and plans for a significant reduction in operating costs. The total cost in 2001 of this restructuring was £200 million, with £152 million borne by Prudential Assurance's long-term fund and £48 million by shareholders' funds. Prudential has allocated these costs between the long-term fund and shareholder businesses on the basis of the activity to which the costs relate. The amount spent as of December 31, 2001 in connection with the above restructurings was £82 million.

As part of these restructurings Prudential planned to make 4,100 jobs redundant, of which approximately 2,000 had been completed by December 31, 2001.

In 1999, Prudential carried out a review of its UK operations and adopted restructuring plans. The cost of the restructuring in 1999 was £148 million. Of this amount, £78 million was borne by Prudential Assurance's long-term fund and £70 million by shareholders' funds. Prudential has allocated these costs between the long-term fund and shareholder businesses on the basis of the activity to which the costs relate. This cost largely related to reductions in the company salesforce pursuant to an involuntary redundancy program, reductions in associated sales management, sales support and administration staff and related property and closure provisions which in total amounted to £131 million, of which £78 million was borne by the long-term fund and £53 million charged directly to shareholders. The remainder represents integration costs of combining Prudential Portfolio Managers and M&G following the acquisition of M&G. The amount spent as of December 31, 2001 in connection with the above restructuring was £97 million.

Distribution

Prudential's UK Insurance Operations have a multi-channel distribution capability relying on direct to consumer, business to business, intermediaries and affinities channels.

Direct to Consumer

The direct to consumer distribution channel is primarily charged with increasing revenue through existing Prudential customers and seeking new customers for the business. The channel builds on the success of the Service Related Sales units and the Annuities Advice center, through which customers are served and advised by the internet and telephone.

Business to Business

The business to business distribution channel focuses on the maximization of the value of the existing book of corporate pension schemes and winning new schemes. At the same time, this channel targets Prudential's strong base of corporate pensions through workplace cross-selling. Prudential UK Insurance Operations corporate pension products are marketed through consulting actuaries, benefits advisers and its company employer and employee relationship management teams. Both consulting actuaries and benefits advisers are IFAs, but are not generally the same as the retail IFAs being targeted via the intermediary channel discussed below.

Intermediaries

The intermediary channel focuses on the distribution of products to individual customers via retail IFAs. This channel was restructured during 2001 to be closely aligned to the needs of Prudential UK Insurance Operations' key intermediary customers, enabling the formation of closer relationships with the intermediaries that provide greatest value. New sales divisions have been created to customize the levels of support required by each key customer group in line with the value that each group generates. This realignment resulted in an increase in the number of telephone-based account managers and a fall in the number of field-based account managers.

Affinities

The newly formed affinity channel will develop partnerships with banks, retail brands and other distributors.

M&G

Prudential's fund management business in the United Kingdom and Europe, M&G, accounted for £75 million of Prudential's total 2001 UK operating profit before taxation and restructuring of £501 million, including discontinued businesses. This business currently comprises a retail fund management business, fixed income institutional, and internal fund management activities.

Following the acquisition of M&G Group plc in 1999, Prudential merged its existing UK fund management operation, Prudential Portfolio Managers, or PPM, into the M&G operation. In the United Kingdom, M&G specializes in those areas of fund management where it believes that it has a competitive advantage. These areas are unit trusts, fixed income and pooled life and pension funds. M&G sold its UK institutional equity business in 2000 as it did not have a competitive advantage in this area.

2001 proved a challenging year for the retail fund management industry with gross industry retail sales falling 22%, net retail sales falling 48% and net ISA sales falling 39%. Excluding an exceptional loan note rollover in 2000 relating to the original acquisition of M&G by Prudential, M&G saw a decrease in gross sales of only 5% and achieved a significant increase in net retail sales over the year. M&G was able to leverage its leading fixed income position and reduce redemptions, in addition to benefiting from an increased recognition among IFAs due to the good performance of a number of its equity funds. This resulted in M&G being responsible for more than 6% of all ISA and PEP transfer business sold via intermediaries in 2001. M&G is the UK's second largest retail fund manager in terms of funds under management.

M&G's strategy of refocusing its institutional business on core areas of strength in fixed interest, defined contribution and pooled pensions, is increasingly producing results as the move away from defined benefit schemes among UK companies gathers momentum. Over £700 million of institutional mandates were won during 2001 with M&G's strengths in liability and cashflow matching being a particular factor behind this growth. See " UK Retail Financial Services Market Overview Products" for an assessment of the impact of FRS 17 on UK companies' pension provisions.

For the second successive year M&G generated strong investment performance across the internal funds for which it was responsible.

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

	At December 31,		
	2001	**2000**	**1999**
	(In £ Billions)		
Retail fund management	**13**	18	15
Institutional fund management	**6**	6	22
Internal fund management	**101**	106	106
Total	**120**	130	143(1)

(1) Includes £12 billion relating to M&G's institutional equity business, which was sold in 2000.

Retail Fund Management

M&G's retail fund management business comprises distribution of its retail investment products and the management of the funds invested in these products by its customers. Total new business contributions for the year ended December 31, 2001 for M&G products, distributed directly and through the IFA channel, were £918 million and comprised 14% of total UK new business contributions.

M&G markets and distributes its range of retail investment products through IFAs, over the phone and through the internet. M&G was one of the first UK providers to offer unit trust purchases over the internet.

Retail Investment Products

M&G distributes retail investment products under the Prudential and M&G brands. M&G offers unit trusts, ISAs, and investment trusts.

Unit Trusts

Unit trusts are the United Kingdom equivalent of mutual funds in the United States. These products are designed for medium to long-term savings and either lump-sum or regular contributions may be made. Investors purchase "units" of the unit trust. A unit represents an interest in the pool of investments underlying the unit trust. The return to investors is determined by the performance of these investments.

ISAs

ISAs are savings products that provide a tax advantage in that the income and capital gains arising are tax-free. Contributions may be made regularly or in a lump sum, subject to the £7,000 maximum per tax year specified by the UK tax authorities until 2005/2006. The UK tax authorities have announced that the ISA products' tax advantages are guaranteed to remain in place until at least 2009. Prudential offers ISA products that "wrap" equity-based and corporate bond-based unit trust products.

Investment Trusts

Investment trusts are similar to closed-end mutual funds and are listed on the London Stock Exchange. The trusts invest in specified investments, typically equities and government securities. Investors purchase shares in the trusts. The return to the investor is based on the trading price of the shares. Prudential offers investment trusts only through M&G.

Internal Fund Management

M&G's internal fund management activities are based in the United Kingdom. Its largest clients are Prudential Assurance's and Scottish Amicable's long-term funds, which together had £80 billion of funds under management at December 31, 2001. Where M&G chooses to invest internal funds in the United States or Asia, this is done through PPM America and PPM Asia, respectively. M&G monitors global investment and economic conditions, while regional fund management offices provide M&G with local knowledge and experience. See "US Business PPM America" and "Asian Business Development of Prudential's Asian Business" for descriptions of PPM America and PPM Asia, respectively.

In the United Kingdom, M&G is one of the largest investment managers, with £120 billion of funds under management at December 31, 2001 (including the funds allocated to PPM America and PPM Asia). These funds represent £101 billion of internal funds, £6 billion of institutional funds and £13 billion of retail funds.

Launch of M&G International

In February 2002, M&G announced the launch of M&G International, focused initially on the distribution of M&G branded mutual funds to institutional investors in Germany and Austria. M&G International is also developing plans for institutional business in Italy and Luxembourg and the retail markets of Germany and Austria.

Egg

Egg had a total operating loss before taxation in 2001 of £88 million, a reduction of £67 million from a loss of £155 million in 2000. Egg broke even in the fourth quarter of 2001, which contributed to Egg's 43% decrease in operating loss before taxation compared to the prior year.

In June 2000, approximately 21% of the shares of Egg plc were offered in an initial public offering. The offering was intended to enable Egg to maximize potential growth in the UK domestic market and, over time, internationally. Egg has continued to develop and enhance its range of products and services, adopting new technologies for the benefit of customers while growing rapidly and retaining its market leading position.

The following table shows the actual balances for Egg products at the dates indicated.

	At December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
Customer deposits	**5,945**	7,128	8,157
Mortgage loans	**2,427**	2,406	1,622
Credit card receivables	**1,769**	929	228
Personal loans	**597**	445	207

Egg currently offers Egg-branded and Prudential-branded banking products and intermediated services on the internet (*www.egg.com*). Egg was launched in October 1998 with the goal of attracting new customers and developing a direct distribution channel. Egg's target customer base is relatively affluent, and it has designed its products and services for customers who manage their own financial affairs, do not need advice, seek consistently good value, simple products and prefer the flexibility offered by remote access. Prudential believes that Egg will continue to develop into a significant business as internet access becomes more commonplace and technology improves.

At Egg's launch, the initial goal was to attract £5 billion in deposits in the first five years. That goal was achieved in the first seven months of operation, principally through opening accounts by telephone, and later over the internet. In April 1999, Egg began accepting new applications for deposit accounts exclusively through the internet.

Products

Egg's products include deposit savings accounts, mortgages, personal loans and credit cards. At December 31, 2001, Egg had total deposits of £5,945 million and over 1.95 million customers. In addition to its traditional deposit account, which can be serviced both over the internet and by telephone, Egg launched in 1999 an internet-only deposit account that may only be applied for and serviced over the internet and offers better rates of interest than its other deposit accounts. At December 31, 2001, Egg's mortgage loan book amounted to £2,427 million and its personal loan book was £597 million. Both mortgages and personal loans can be applied for over the internet. Administration fees are waived on Egg's internet mortgage products. Egg Card, the UK's first credit card designed for the internet, was launched in September 1999. At December 31, 2001, the balance outstanding on credit cards was £1,769 million. In April 2000, Egg announced a partnership with The Boots Company plc to distribute a joint credit and loyalty card to Boots customers. Egg also launched an independent, execution-only unit trust supermarket on its website in March 2000 together with an independent, execution-only personal lines insurance supermarket. As at December 31, 2001, Egg had received over £130 million of funds via its unit-trust supermarket since launch.

In July 2001, Egg signed a commercial agreement with Microsoft to provide online financial products. The first stage of the agreement is to provide a unit trust and ISA fund supermarket via MSN in the United Kingdom. Detailed plans to extend this relationship from funds into other financial products and services, and from the United Kingdom into the rest of Europe, are being developed.

Prudential believes that Egg has gained a significant advantage in the provision of internet-based financial services by being among the first to the market with the services and products it offers. Egg has developed into an online marketplace, enabling clients to obtain products and services ranging from core banking products and related financial services to intermediated financial and non-financial products and services, and continues to investigate opportunities in several markets and product sectors in the United Kingdom and internationally. See " Acquisitions" below.

Acquisitions

In January 2002, Egg announced that, subject to regulatory approval, it will be acquiring 100% of Zebank, a French direct financial services company, for €8 million in cash (£5 million). Egg will also reimburse the shareholders for €30 million (£18 million) cash injected into the business during the period between signing and completion to ensure all share capital is fully paid up. Zebank's net asset value as at December 31, 2001 was €31million (£19 million) and the company had 70,000 customers at that date. Egg will distribute its financial services products through Zebank's distribution partners, which now include French retailers Sephora and La Samaritaine.

In January 2002, Egg announced it had acquired Fundsdirect, an on-line fund supermarket, for £3 million. The merger of Egg Invest with Fundsdirect represents the consolidation of two of the United Kingdom's leading fund supermarkets, combining Egg's leading edge, scale, digital services capability and consumer offering with Fundsdirect's proven ability to serve the business to business marketplace. The net assets of Fundsdirect at December 31, 2001 were £2.7 million.

Reinsurance

Long-term Insurance

In view of the size and spread of Prudential Assurance's long-term insurance fund, there is little need for reinsurance to protect this business. Some limited reinsurance is maintained and treaties relating to critical illness and permanent health insurance and term insurance are in place.

Personal Lines Property and Casualty Insurance

In common with other insurance companies, Prudential ceded some of its personal lines property and casualty insurance risks to companies outside its group. Prudential ceded risk primarily to reduce its potential liability on a major weather-related event under its domestic insurance policies. Reinsurance also provided some protection against individual large losses. Reinsurance did not discharge the original insurer's primary liability to the insured.

Prudential's catastrophe reinsurance treaties provide reinsurance for losses arising from any one incident in excess of £50 million (and up to £250 million) on the whole property account.

On its motor account, Prudential had excess of loss reinsurance arrangements in place to provide cover against individual claims in excess of £1 million. Prudential also reinsured, on a quota share basis, 90% of the risk arising under mortgage guarantee business and 75% of the risk arising under legal expense cover offered as optional benefits under household and motor policies.

Prudential placed catastrophe reinsurance and motor reinsurance with a large number of reinsurers, including Lloyd's of London and specialist reinsurance companies. Prudential required all its reinsurance to be ceded to reinsurance companies with a credit rating of A or above.

In addition, in accordance with UK accounting regulations, a claims equalization provision was retained which could be drawn upon in the event of the claims ratio on Prudential's domestic insurance business exceeding 72.5%. At December 31, 2001, this provision was £40 million.

On December 31, 2001 the insurance liabilities were almost wholly reinsured to Winterthur, as part of the transfer of Prudential's personal lines property and casualty business to Winterthur and its UK subsidiary Churchill. See " Personal Lines Property and Casualty Insurance Transfer of Business to Winterthur".

Reserves

In the United Kingdom, a long-term insurance company's reserve requirements are determined by its appointed actuary, subject to minimum reserve requirements. These minimum reserve requirements are established by regulations under the Insurance Companies Act 1982 and have been interpreted by mandatory professional guidance notes.

The reserves are published in annual returns to the UK supervisory authority. In practice similar provisions are included in the life insurance company's statutory accounts with limited adjustments. Whether an employee of, or consultant to, an insurance company, an appointed actuary must give due regard to policyholders' reasonable expectations in making recommendations to a company's board of directors. Mandatory professional guidance notes require an appointed actuary to report directly to the UK supervisory authority any serious concerns regarding a company's ability to meet the reasonable expectations of its policyholders.

Prudential's reserving for with-profits products takes into account annual bonuses/annual interest credited to policyholders because these are "attached" to the policies and are guaranteed. Prudential also makes implicit allowance for future annual bonuses and interest as required by the UK regulations. No reserves are provided for terminal bonuses, except for the period for which they have been declared.

Prudential reserves for unit-linked products on the basis of the value of the unit fund and additional reserves are held for expenses and mortality where this is required by the contract design.

Financial Strength of Prudential Assurance's Long-term Fund

A common measure of financial strength in the United Kingdom for long-term insurance business is the free asset ratio. The free asset ratio represents the ratio of assets less liabilities to liabilities and is expressed as a percentage. At December 31, 2001, Prudential Assurance's free asset ratio was 12%, compared to a ratio of 17% at December 31, 2000. The principal reason for the lower ratio at December 31, 2001 was due to the fall in equity markets in 2001.

For Prudential Assurance, the free assets in the long-term fund provide cover for the minimum solvency margin required by regulations under the UK Insurance Companies Act 1982. At December 31, 2001, Prudential Assurance had a solvency margin equal to 205% of the statutory minimum. The long-term fund remains well capitalized. Prudential Assurance's long-term fund is currently rated AAA by Standard & Poor's and Aaa by Moody's.

Solvency requirements in the United Kingdom include the establishment of a resilience reserve which makes prudent allowance for potential future movements in investment values. In September 2001, the FSA relaxed the recommended resilience tests in response to changing economic conditions and extreme market conditions at the time. Pending the outcome of FSA consultation on the resilience tests that should be applied in the future, Prudential has applied the rigorous tests previously specified by the FSA (prior to September 10, 2001). As at December 31, 2001 the overall liability was based on the following combined resilience scenario:

- fall in equity values of 25%;
- fall in property values of 20%; and
- fall in bond values of 17% (consistent with an increase in interest rates of 3%).

Shareholders' Interests in Prudential's Long-term Insurance Business

In common with other UK long-term insurance companies, Prudential's products are structured as either with-profits or non-participating products, which include unit-linked products. For statutory and management purposes, Prudential Assurance's long-term fund consists of a number of sub-funds in which shareholders and policyholders have varying interests.

With-profits Products

With-profits products provide an equity-type return to policyholders through bonuses that are "smoothed". There are two types of bonuses: "annual" and "terminal". Annual bonuses, often referred to as reversionary bonuses, are declared annually and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, terminal bonuses are only guaranteed until the next bonus declaration. Terminal bonuses are only credited on a product's maturity or surrender or on the death of the policyholder. Terminal bonuses typically represent a substantial portion, which can be as much as 70% of the total, of the ultimate return to policyholders.

With-profits policies are supported by a with-profits fund. Prudential's primary with-profits fund is part of Prudential Assurance's long-term fund. With-profits products provide benefits that are generally either the value of the premiums paid, or the guaranteed death and maturity benefit, plus the bonuses declared. 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 terminal bonuses declared.

The return to Prudential's shareholders in respect of bonuses on the with-profits products Prudential writes is currently an amount equal to up to one-ninth of the value of the bonuses Prudential credits or declares in that year. Prudential has a large block of in-force with-profits business with varying maturity dates that generates a relatively stable stream of shareholder profits from year to year.

Prudential's With-profits Bonus Policy

Prudential Assurance's board of directors, with the advice of its appointed actuary, determines the amount of annual and terminal bonuses to be declared each year on each group of contracts.

When determining policy payouts, including terminal bonuses, Prudential 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 Prudential notionally attributes to the policy. In calculating asset shares, Prudential takes into account the following items:

- the cost of mortality risk and other guarantees (where applicable),
- the effect of taxation,
- expenses, charges and commissions,
- the proportion of the amount determined to be distributable to shareholders, and
- the surplus arising from surrenders and non-participating business included in the with-profits fund.

However, Prudential does not take into account the surplus assets of the long-term fund, or their investment return, in calculating asset shares. Asset shares are used in the determination of terminal bonuses together with policyholders' reasonable expectations, the need to smooth claim values and payments from year to year and competitive considerations.

Prudential is required by UK law and regulation to consider the reasonable expectations of its policyholders in setting bonus levels. The concept of policyholders' reasonable expectations 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 Prudential Assurance's long-term fund, enabling it to maintain high levels of investment in equities and real estate, which have historically provided a return in excess of fixed interest securities.

In 2001, Prudential declared total bonuses of £3,100 million from Prudential Assurance's long-term fund of which £2,790 million was added to with-profit policies and £310 million was distributed to shareholders. This reflects annual bonus rates of 4% for the Prudence Bond and 4.5% for personal pensions. In 2000, Prudential declared total bonuses of £3,103 million, of which £2,796 million was added to with-profit policies and £307 million was distributed to shareholders. This reflected regular bonus rates of 4.5% for the Prudence Bond and 5% for personal pensions. In 1999, Prudential declared total bonuses of £3,040 million, of which £2,736 million was added to with-profit policies and £304 million was distributed to shareholders. This reflected regular bonus rates of 4.75% for the Prudence Bond and 5.25% for personal pensions.

The SAIF fund declared total bonuses in 2001 of £690 million, compared to £641 million in 2000 and £641 million in 1999. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business. For greater detail on the SAIF fund, see " The SAIF Sub-fund and Accounts" below.

The FSA and HM Treasury are currently conducting independent reviews of with-profits business in the United Kingdom. See "Supervision and Regulation of Prudential UK Supervision and Regulation".

Surplus Assets in Prudential Assurance's Long-term Fund

Surplus assets are the assets of Prudential Assurance's long-term, with-profits fund less non-participating liabilities and the policyholder asset shares aggregated across with-profits policies, and any additional amounts expected at the valuation date to be paid to in-force policyholders in the future in respect of smoothing costs and guarantees. Thus surplus assets are amounts in the long-term fund in excess of what Prudential expects to pay to policyholders.

These surplus assets have accumulated over many years from a variety of sources and provide the long-term fund with working capital. This working capital permits Prudential to invest a substantial portion of the assets of the long-term fund in equities and real estate, smooth investment returns to with-profits policyholders, keep Prudential's products competitive, write new business without being constrained as to cash flows in the early years of the policy, and demonstrate solvency.

In addition, Prudential can use surplus assets to absorb the costs of significant events, such as fundamental strategic change in its long-term business and, as approved by the UK regulator, the cost of Prudential's pension mis-selling, without affecting the level of distributions to policyholders and shareholders. The costs of fundamental strategic change may include investment in new technology, redundancy and restructuring costs, cost overruns on new business and the funding of other appropriate long-term insurance related activities including acquisitions.

The aggregate with-profits policyholder asset shares upon which the calculation of surplus assets is based are not used in any form of external reporting or for internal financial reporting and do not form part of Prudential's accounting books and records. Asset share methodology has evolved only over the past 20 to 30 years to assist in the determination of bonus rates. Unlike the calculations for determining bonuses, the calculation of aggregate with-profits asset shares requires calculations to be performed in respect of all in-force with-profits policies. These calculations depend upon the experience of each current with-profits policy in respect of mortality, expenses, investment returns, taxation and transfers to shareholders over the duration that the policy has been in force. As Prudential does not have the detailed historical data for all policies required to calculate a precise aggregate asset share for each class of policy, Prudential can only estimate the overall aggregate asset share and hence can only estimate surplus assets.

The size of the surplus assets reflects both the investment performance on the with-profits fund assets and any change over the year in the amounts which Prudential expects to pay to policyholders. This latter amount includes both the aggregate asset shares and the anticipated costs of smoothing and guarantees for the in-force with-profits business. The anticipated costs of smoothing and guarantees depend upon the projection of claim values and asset shares, and hence on assumptions about future experience. By their nature, assumptions about the future may vary from year to year and hence the anticipated costs of smoothing and guarantees will tend to fluctuate from year to year. Prudential estimates that at December 31, 2001, its surplus assets, after taking into account pension mis-selling costs and the anticipated costs of fundamental strategic change, were in the range of £6 billion to £8 billion.

In recent years, a number of UK life insurance companies have reached agreement with the relevant UK supervisory authority to permit them to attribute a proportion of the surplus assets in their long-term funds to their shareholders while retaining it in their long-term funds. To date, the supervisory authority has permitted companies to distribute only a modest proportion of the amounts attributed to them.

Prudential continues to pursue opportunities to resolve the ultimate attribution of the surplus assets in the main with-profits fund, and have, since 1996, been discussing this attribution with the relevant UK supervisory authorities. The attribution of surplus assets has also been a subject of public debate in the United Kingdom. This may or may not result in a portion of the surplus assets in the main with-profits fund being attributed solely to shareholders. See " Legal Proceedings Prudential Assurance Surplus Assets" below.

The amount and timing of any attribution to shareholders is sufficiently uncertain that it is not possible to accurately estimate any potential attribution. In addition, it is likely that if any surplus assets are attributed to shareholders they will remain in the long-term fund to support the long-term business, and accordingly, they are unlikely to be distributed to shareholders for some considerable period of time, if at all.

Depletion of Surplus Assets and Shareholders' Contingencies

As a proprietary insurance company, Prudential remains liable to meet its obligations to policyholders even if the assets of its long-term fund are insufficient to do so. The surplus assets in Prudential's long-term fund could be materially depleted over time, by, for example, a significant or sustained equity market downturn, significant fundamental strategic change costs, or material increases in the pension mis-selling provision. In the unlikely circumstance that the depletion of the surplus assets within the long-term fund was such that Prudential believed that its ability to satisfy policyholders' reasonable expectations was adversely affected, it might become necessary to restrict the annual distribution to shareholders or for Prudential to contribute shareholders' funds to the long-term fund to provide financial support.

The SAIF Sub-Fund and Accounts

The SAIF sub-fund is a ring-fenced sub-fund of Prudential Assurance's long-term fund and was formed following the acquisition of Scottish Amicable in 1997. No new business may be written in SAIF, although regular premiums are still being paid on policies in-force at the time of the acquisition and "top-ups" are permitted on these policies.

This fund is solely for the benefit of those Scottish Amicable Life Assurance Society policyholders whose policies were transferred to SAIF. Shareholders have no interest in the profits of this fund, although they are entitled to the investment management fees paid on this business. The brand name and rights to profit on new business were transferred to a new Prudential subsidiary, Scottish Amicable Life plc, which operates for the benefit of shareholders.

At the time of the acquisition, Prudential Assurance's long-term fund made payments of £276 million to the SAIF sub-fund for the unit-linked life business and non-participating life business and the future profits from unitized with-profits life business. Prudential Assurance also agreed to set up a memorandum account of £1.3 billion that is considered in determining SAIF's investment policy. The sub-fund pays an annual charge to the other part of Prudential Assurance's long-term fund with respect to this memorandum account.

Prudential Assurance's long-term fund made a further payment of £185 million to qualifying Scottish Amicable Life Assurance Society policyholders for the use of the Scottish Amicable brand and future expense synergies. This payment will be recovered by the long-term fund by means of a combination of a service agreement and a license fee agreement with Craigforth Services Limited, a shareholder-owned service company set up at the time of the acquisition.

In addition to the payments described above, shareholders paid £415 million to qualifying Scottish Amicable Life Assurance Society policyholders representing goodwill, and £70 million for certain Scottish Amicable Life Assurance Society strategic investments.

The SAIF sub-fund has not been affected by the decision taken to no longer sell under the Scottish Amicable brand. See " UK Restructurings".

Non-participating Business

The vast majority of Prudential-branded non-participating business is written in Prudential Assurance's long-term fund or by subsidiaries owned by the fund. Prudential's principal non-participating business is Prudential Annuities Limited. The profits on this business are attributable to the fund and not to shareholders, although indirectly shareholders get one ninth of additional amounts paid to policyholders. In 2001, Prudential started to write new bulk annuity and individual external annuity business through Prudential Retirement Income Limited (PRIL), from which the profits are attributed solely to shareholders.

The unit-linked business written by Scottish Amicable Life plc and Scottish Amicable Life International is written against capital provided by shareholders. All profit from these businesses goes to shareholders.

Small amounts of long-term sickness and accident cover are written against capital provided by shareholders and, accordingly, all profit on this business goes to shareholders.

Compliance

From December 1, 2001, the FSA took formal responsibility for the regulation and supervision of all Prudential's authorized UK insurance, investment and banking businesses under the Financial Services and Markets Act 2000, as described in greater detail under " Supervision and Regulation of Prudential UK Supervision and Regulation".

During 2001, the various UK regulators whose functions had been absorbed into the FSA merged their supervisory teams dealing with Prudential's businesses into one team in the FSA's Major Financial Groups Division. Matters being dealt with by the previous supervisors were taken up by the new team and an induction program has been undertaken to help familiarize the new team with each of Prudential's UK businesses. In addition, the FSA takes a view of the group's management of its non-UK businesses, in order to understand how group-wide risks are managed and their potential impact on UK regulated businesses. This helps the FSA meet its statutory objectives.

Within Prudential's UK businesses, matters arise from time to time as a result of inspection visits or other regulatory activity, which need to be discussed or resolved with the regulators. At any one time, there are a number of these issues and Prudential ensures that programs of corrective activity are discussed and agreed with the appropriate regulator, that such programs are properly planned, managed and resourced (using external resources as necessary), that, where appropriate, policyholders who have been disadvantaged are properly compensated and that progress is reported to the regulators on a regular basis. The issues that affect Prudential are set out below. Some of these are industry-wide.

Mortgage Endowment Products

One industry issue concerns low-cost endowments related to repayment of residential mortgages. At sale, the initial sum is set at a level such that the projected benefits assured, including an estimate of the annual bonus receivable over the life of the policy and allowing for an estimate of the expenses to be charged, will equal or exceed the mortgage debt. Because of a decrease in expected future investment returns since relevant policies were sold, the UK regulator is concerned that the maturity value of some policies will be less than the mortgage debt. The UK regulator has worked with industry representatives to devise a program whereby companies will write to customers indicating if they may have a possible anticipated shortfall and outlining the actions customers can take to prevent this possibility. The Group's main exposure to mortgage endowment in this respect is through Scottish Amicable's ringfenced SAIF with-profits sub-fund established for policies written before its acquisition by Prudential in 1997.

The FSA issued a report in March 2001 raising concerns regarding Scottish Amicable's conduct of sales of these products by its tied agents since 1999. Prudential has agreed to review business written up to February 2001 to identify cases where customers may have been disadvantaged and to offer rectification. If necessary, certain cases before 1999 may also be reviewed. In addition, the FSA is considering whether disciplinary action should be taken against Scottish Amicable. Scottish Amicable withdrew from the mortgage endowment product market in April 2001 and disbanded its network of tied agents in September 2001.

Pension Mis-selling

In 1988, the UK government introduced new pensions legislation in the UK Income and Corporation Taxes Act 1988 intended to encourage more individuals to make their own arrangements for their pensions. During the period from April 1988 to June 1994, many individuals were advised by insurance companies, IFAs and other intermediaries to not join, to transfer from, or to opt out of their occupational pension schemes and to invest in private pension products. The UK regulators subsequently determined that many individuals were incorrectly advised and would have been better off not purchasing the private pension product sold to them. Industry participants are responsible for compensating the persons to whom pensions were mis-sold.

The UK regulators have established a program for the pension industry that provides the framework for reviewing cases of mis-selling, determining the appropriate remedial action and apportioning costs of remedial action and associated expenses. The UK regulators have divided the review into two phases. Phase 1 cases, originally referred to as priority cases, consist primarily of cases where the investor was close to retirement or had died or retired since purchasing the pension product. Phase 2 cases, originally referred to as non-priority cases, are primarily younger investors who have retirement dates that are not near-term. The regulators established deadlines for reviewing cases and have the power to impose sanctions where companies fail to meet the deadlines or otherwise do not comply with the regulators' guidelines for the resolution of cases of pension mis-selling.

In line with other industry participants, Prudential has been working with regulators to resolve cases of pension mis-selling. Prudential continues to review potential cases of mis-selling to determine what remedial action needs to be taken. The review of potential cases of mis-selling is difficult, requiring a complicated comparison of the value of the pension product provided to the value of the pension that the individual would have had if the individual had joined or remained with an occupational scheme. This is further complicated by the fact that the comparisons are dependent on information that has to be obtained from third parties.

Prudential is not permitted to offer cash to its customers affected by pensions mis-selling. The preferred form of redress is reinstatement to the occupational pension scheme, but where this is not possible, Prudential has either enhanced the benefits under the personal pension or issued investors with a "guarantee". The nature of these "guarantees" is such that Prudential will guarantee that the value of the benefits payable under a personal pension will be at least equal to the value of the benefits that would have been provided by the occupational pension scheme.

In 1997, Prudential was criticized by the regulators for the conduct of Phase 1 of its pensions review. The regulator then carried out a visit in early 1999 and raised concerns relating to the proper completion of certain aspects of this phase. Those concerns were the subject of a further review by external consultants on behalf of the regulator and Prudential from August 1999 to March 2001. In October 2001, Prudential was fined £650,000 for delays in making payments of redress to supplement pension policy benefits of those who had retired and the beneficiaries of those who had died, and for deficiencies in its record keeping. A process for settling all outstanding Phase 1 cases has been agreed with the FSA.

Phase 2 began in 1999 and Prudential is on schedule to complete this phase by June 30, 2002 under the timetable imposed by the UK regulators. This may include the issue of a limited number of guarantees, for which permission has been requested from the FSA.

In connection with the pension mis-selling review, Prudential established an initial provision in 1994 that was increased to £1,100 million by 1999. Subsequent movements in the pension mis-selling provision have been as follows:

	Year Ended December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
Balance at January 1	**1,475**	1,700	1,100
Changes due to expanded scope of review			202
Changes to actuarial assumptions and method of calculation	**(89)**	(117)	261
Increase in provision for administrative expenses		50	190
Discount unwind	**89**	102	66
Redress to policyholders	**(273)**	(134)	(73)
Payments of administrative expenses	**(137)**	(126)	(46)
Balance at December 31	**1,065**	1,475	1,700

In 2001, the provision for pension mis-selling decreased by £410 million compared to a decrease of £225 million in 2000. The reasons for this movement are highlighted below.

In 1999, the scope of the pension mis-selling review was expanded by the UK regulator to include Phase 2 cases. As a result, Prudential increased the provision by £202 million to reflect the increase in the number of cases to be reviewed and the possible increase in the amount to be paid to policyholders. There were no changes in scope in 2000 and 2001.

In 2001 and 2000, the liability was decreased by £89 million and £117 million respectively and in 1999, the liability was increased by £261 million, to reflect changes in the method of calculation resulting from new requirements issued by the UK regulator and changes in the interest rate and mortality assumptions used.

The increase in the provision for administrative expenses of £50 million and £190 million in 2000 and 1999, respectively, reflects the additional administrative costs expected to be incurred predominantly due to the shortening of Prudential's deadline for completing the Phase 2 cases by the UK regulator from December 2004 to June 2002.

The pension mis-selling liability represents the discounted value of future expected payments and as a consequence, to the extent that amounts have not been paid, the provision increases each year reflecting the unwind of the discount. The increase in the provision relating to unwind of the discount amounted to £89 million in 2001, £102 million in 2000 and £66 million in 1999.

Prudential believes that, based on current information, the pension mis-selling liability, together with future investment return on the assets backing the liability, will be adequate to cover the costs of pension mis-selling as well as the costs and expenses of Prudential's pension review unit established to identify and settle such cases. The provision represents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased. Prudential has estimated, based on current regulatory guidelines, that the discounted present value of reasonably possible losses might range up to an additional £65 million over that provided at December 31, 2001. This potential additional provision has been determined using more stringent assumptions, in respect of customer responses to mailings and redress in comparison to external occupational schemes, applied to those cases identified at December 31, 2001.

The calculation of the pension mis-selling provision is dependent upon a number of assumptions and requirements provided by the UK regulator. Throughout the pension mis-selling review process, the UK regulator has made changes to its requirements. Therefore, it is not possible to predict any additional changes to its requirements and any resultant changes to the provision that might be made in the future.

As approved by the UK regulator, the total cost of Prudential's pension mis-selling, including the fine referred to above, is funded from the surplus assets of Prudential Assurance's with-profits fund and not from amounts set aside to fund expected future payments to existing policyholders and the related shareholder transfers. Given the strength of the with-profits fund, Prudential believes that charging the provision to the surplus assets in the fund will not have an adverse impact on the levels of bonuses paid to policyholders or their reasonable expectations. In the unlikely event that this proves not to be the case, Prudential intends that appropriate support would be provided to the long-term fund from shareholders. In view of the uncertainty, it is not practicable to estimate the level of this potential support.

Mis-selling of personal pension products has not been limited to company salesforces. Tied agents, including some of the tied agents of Scottish Amicable Life Assurance Society, have also been found to have mis-sold personal pension products. Compensation in respect of mis-selling by Scottish Amicable Life Assurance Society tied agents is being paid from the "ring-fenced" SAIF with-profits sub-fund established for this business.

Free Standing Additional Voluntary Contribution Business

In February 2000, the UK regulator ordered a review of Free Standing Additional Voluntary Contribution business, which constitutes sales of personal pensions to members of company pension schemes. Individuals who have purchased these pensions instead of the Additional Voluntary Contributions ("AVC") scheme connected to their company's pension scheme may have been in a better financial position by investing their money, and any matching contributions from their employers, in their company's AVC scheme. The purpose of the UK regulator's review is to ensure that any employees disadvantaged due to not being properly informed of the benefits foregone from not investing in their AVC scheme are compensated.

The review requires companies to identify relevant investors and contact them offering to review their individual case. As a result of the work completed to date, Prudential has established a provision at December 31, 2001 of £42 million. The deadline for completing the reviews is December 31, 2002, with an interim deadline of 90% of cases completed by June 30, 2002. Prudential is discussing with the FSA delays by pension schemes in responding to requests for information.

Prudential believes that, based on current information, the provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of reviewing Free Standing Additional Voluntary Contribution business as well as the costs and expenses of Prudential's review unit established to identify and settle such cases. The provision represents Prudential's best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

Guaranteed Annuities

During the 1970s and 1980s, life insurance companies sold personal and corporate pension policies with a guaranteed annuity rate on maturity. Due to prevailing bond yields in the late 1990s, the guaranteed levels of typically £110 per annum for a lump sum of £1,000 is now significantly above the prevailing market level (around £80 per £1,000). Prudential Assurance did not sell significant volumes of these products and has established a provision of £34 million to honor the guarantees on the products sold. Scottish Amicable Life Assurance Society sold significant volumes of these policies and provisions of £756 million have been established within the segregated with-profits SAIF sub-fund to deal with this exposure. Accordingly, this provision has no impact on shareholders.

US Business

Prudential conducts its US insurance operations through Jackson National Life Insurance Company and its subsidiaries. The US operations also include PPM America, Prudential's US internal and institutional fund manager, Prudential's US broker-dealer operations (National Planning Corporation, SII Investments, Inc., IFC Holdings, Inc. and Investment Centers of America, Inc.) and Jackson Federal Bank, Prudential's savings and loan institution. At December 31, 2001, Prudential's US operations had approximately 1.5 million policies and contracts in effect and £30.3 billion of funds under management in the United States. In 2001, total new business premiums were £4,634 million and operating profit before amortization of goodwill and tax was £298 million.

US Market Overview

The United States is the world's largest life insurance market in terms of premiums. Many of the factors that have affected the UK life insurance market in recent years, such as an ageing population and strong economic conditions, have also affected the US market. Uncertainties surrounding the adequacy of public and private pensions benefits are increasing the incentive to fund a secure retirement privately, and the demand for income products is also expected to increase as the baby boomer generation and its parents age.

Despite favorable demographics, the US insurance industry faces a number of challenges, both from within and outside of the industry. The life insurance business is projected to grow only slowly, if at all, and competition is fierce. While the growth prospects for the annuity industry are more favorable, there are many players fighting for market share. Likewise, there is competition for retirement savings from other financial services providers, in particular, mutual fund companies and banks.

Mutual fund companies have set the standard for cost structure and service in the US financial services industry. Mutual fund products are inherently less complex, permitting providers to have a cost structure that allows more of the investment returns generated by the investment portfolios to flow to the customer. This fact and the relatively strong historical financial markets over recent years have resulted in the long-term trend of mutual fund companies taking market share from both banks and insurance companies.

There has been increasing convergence between US retail financial services providers as regulatory barriers have begun to erode and competition in the US life insurance industry has increased. Overcapacity in the industry generally has also contributed to competitive pricing and fueled consolidation, presenting opportunities to companies with financial strength and below industry-average cost structures.

The US markets witnessed a year of unprecedented uncertainty in 2001, with equity markets suffering significant declines and bond defaults reaching record levels. Like its competitors, Jackson National Life was affected by these market forces. However, long-term demographic trends in the United States are favourable and Prudential has continued to develop and enhance its product range and distribution channels to ensure that it is well placed to benefit from the anticipated growth in the US financial services market.

Products

The demographic factors described above, as well as the increased reliance on defined contribution plans (such as 401(k) plans), have resulted in a shift in the financial services market. This shift has been away from risk protection products, such as traditional life insurance, to tax deferred savings (or asset accumulation) products, such as fixed and variable annuities. These products tend to be spread or fee-based and have accounted for a significant portion of the growth in the US insurance industry in recent years.

When life insurance and annuity products initially became popular in the United States, they were interest-rate based and provided a minimum guaranteed rate of return. However, declining interest rates eroded the after-tax benefits of these products. Meanwhile, up until 2000 there was significant growth in equity markets. As a result, equity-based and equity-linked products, with and without guarantees, have become increasingly important product offerings. Reflecting this shift, industry sales of individual variable annuity products grew from $29 billion in 1992 to $128 billion in 2000, a compound annual growth rate of 20.7%. During the same period, industry individual variable annuity assets grew from $212 billion to $971 billion, a compound annual growth rate of 20.9%.

The mutual fund industry has also benefited from the shift to equity-based products. The strong equity markets in the late 1990s fueled a growth in assets under management, both through investment returns and increased contributions from the retail sector. In particular, fund managers with strong brands and investment performance have provided strong competition for individuals' retirement savings.

The above trends reversed in 2001, when, for the first time in twelve years, industry-wide variable annuity sales did not increase. Industry-wide sales of variable annuities in 2001 fell to $113 billion, and variable annuity assets were also down to $883 billion, due to low in-flows and a decrease in equity prices. Primarily as a result of falling equity markets, Jackson National Life's sales of variable annuities in 2001 were £768 million ($1,106 million), down 55% from 2000.

Distribution

Traditionally, insurance companies distributed their products through career or independent agencies. The career agencies typically received office space, training and administrative support from the sponsoring insurance company in return for directing a significant portion of their business to them. Independent agencies may receive some support from a specific insurance company, but are typically not required to specifically sell their products. The independent agencies have the ability to sell products from any insurance company.

In contrast, broker-dealers are licensed to sell products regulated by the Securities and Exchange Commission, such as variable annuities. Broker-dealers maintain "panels" of preferred providers for each type of product. Broker-dealers are often organized into firms and networks typically depending on size and function. These consist of large broker-dealers specializing in security sales and underwriting, regional broker-dealers who sell securities and perform some underwriting functions, and independent broker-dealers who primarily specialize in financial planning activities. Recently, there has been an industry trend towards insurance companies owning financial planner broker-dealers.

Until recently, regulatory barriers prohibited banks from developing and selling their own insurance products. Banks have therefore generally developed favorable supplier relationships with insurance companies and distributed their products through bank branches. These barriers to entry have begun to diminish, and alliances such as Citigroup are developing the bancassurance model in the US market.

Direct distribution is relatively mature in the United States. Consumers are accustomed to purchasing less complex retail financial products remotely, both by telephone and via the internet. The mutual fund providers have led this expansion within the retail financial services industry, setting the standard for cost structure and service.

Jackson National Life

Jackson National Life is a leading provider of long-term savings and retirement products to retail and institutional customers throughout the United States. Jackson National Life offers variable annuities, equity-indexed annuities, individual fixed annuities, life insurance and stable value products. By developing and offering a wide variety of products, Jackson National Life believes that it has positioned itself to compete effectively in various stock market and interest rate environments. Jackson National Life markets its retail products through various distribution channels, including independent agents, broker-dealer firms, including financial planners, and banks.

The interest-sensitive fixed annuities, equity-indexed fixed annuities, immediate annuities and life insurance products are sold through independent agents, broker-dealers and banks. For variable annuity products, which can only be sold through broker-dealers licensed by the US National Association of Securities Dealers, Jackson National Life has selling agreements with such firms and is continuing to focus on its own broker-dealer distribution channel. Its group pension department sells stable value products.

Products

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

	Year Ended December 31,			Policyholder Reserves At December 31, 2001
	2001	**2000**	**1999**	
	(In £ Millions)			
By Product				
Annuities				
Fixed annuities				
Interest-sensitive	**1,812**	985	783	**11,742**
Equity-indexed	**271**	409	431	**1,778**
Immediate	**87**	71	43	**773**
Variable annuities	**768**	1,709	1,187	**4,234**
Total	**2,938**	3,174	2,444	**18,527**
Life insurance	**22**	25	24	**3,697**
Stable value products				
GICs and funding agreements	**170**	365	994	**2,539**
Medium term note funding agreements	**1,504**	1,291	624	**3,144**
Total	**1,674**	1,656	1,618	**5,683**
Total	**4,634**	4,855	4,086	**27,907**
By Distribution Channel				
Independent agents	**1,139**	1,099	942	
Bank	**1,052**	631	467	

	Year Ended December 31,		
Broker dealer	**769**	1,469	1,059
Group pension department	**1,674**	1,656	1,618
	4,634	4,855	4,086

Annuities

The annuity products offered include:

- fixed annuities, including:
  - interest-sensitive,
  - equity-indexed, and
  - immediate annuities, and
- variable annuities.

Fixed Annuities

Interest-sensitive Annuities

In 2001, interest-sensitive fixed annuities accounted for 39% of total new business premiums and 42% of policyholder reserves of the US operations. Interest-sensitive fixed annuities are primarily deferred annuity products that are used for retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The policyholder of an interest-sensitive fixed annuity pays Jackson National Life a premium that is credited to an accumulation account. Periodically, interest is credited to the accumulation account and in some cases administrative charges are deducted from the accumulation account. Jackson National Life makes benefit payments at a future date as specified in the policy based on the value of the accumulation account at that date.

The policy provides that at Jackson National Life's discretion it may reset the interest rate on each policy anniversary, subject to a guaranteed minimum. By law, the minimum guarantee may not be less than 3% but for some older business it may be higher.

When the annuity matures, Jackson National Life either pays the amount in the accumulation account to the policyholder or begins making payments in the form of an immediate annuity product, in accordance with the policyholder's instructions. Fixed annuity policies provide for surrender charges to be assessed on surrenders generally for the first seven to nine years of the policy.

Approximately 21% of the interest-sensitive fixed annuities Jackson National Life wrote in 2001 provide for an adjustment, referred to as a market value adjustment, on surrenders in the surrender period of the policy, typically for the first nine years. This adjustment does not depend on the performance of specific assets (as in a variable annuity), but is linked to a formula that helps to match the surrender value to the value of the accumulation account at the time of surrender. The minimum guaranteed rate is not affected by this adjustment.

Jackson National Life bears the investment and surrender risk on interest-sensitive fixed annuities, and its profits come from the spread between the yield on investments and the interest credited to policyholders less initial and recurring management expenses.

Equity-indexed Annuities

In recent years, Jackson National Life's fixed annuity sales have benefited from the introduction of equity-indexed annuity products. In 2001, Jackson National Life maintained a top five market position in the sale of equity-indexed annuities in the United States based on gross premiums. During that period, equity-indexed annuities accounted for 6% of total new business premiums and 6% of policyholder reserves of US operations.

Equity-indexed annuities are deferred annuities that enable policyholders to obtain a portion of an equity-linked return but provide a guaranteed minimum return. Jackson National Life guarantees an annual minimum interest rate of 3%, but actual earnings may be higher and are based on a participation (referred to as the index participation rate) in an equity index over its term. Jackson National Life may reset the index participation rate for each premium deposit. The participation rate set applies for the term selected.

Jackson National Life hedges the equity return risk on equity-indexed products by purchasing futures and options on the relevant index. The cost of these hedges is taken into account in setting index participation rates. Recent volatility in the equity markets combined with lower bond yields has increased the cost of these hedges. In response, Jackson National Life has reduced its index participation rates on new business and developed new products with index participation rates that are less sensitive to changes in these variables.

Jackson National Life bears the investment and surrender risk on equity-indexed fixed annuities. Profit arises from the difference between the premiums received plus the associated investment income and the combined costs of general expenses, purchasing fixed interest securities to fund the basic guaranteed liability and purchasing options to hedge the equity return element of the policy benefits.

Immediate Annuities

In 2001, immediate annuities accounted for 2% of total new business premiums and 3% of policyholder reserves of US operations. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years or the life of the policyholder. If the term is for the life of the policyholder, then Jackson National Life's primary risk is mortality risk. This product is generally used to provide a guaranteed amount of income for policyholders and is used both in planning for retirement and in retirement itself. Jackson National Life expects the market for this product to grow as more people reach retirement age. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

Variable Annuities

Jackson National Life began offering variable annuity products in 1995. In 2001, variable annuities accounted for 17% of total new business premiums and 15% of policyholder reserves of US operations. These sales were down 55% on the prior year reflecting a downturn in industry variable annuity sales due to volatile equity markets. Variable annuities are deferred annuities that have the same tax advantages and payout options as interest-sensitive and equity-indexed fixed annuities. They also are used for retirement planning and to provide income in retirement.

The primary differences between variable annuities and interest-sensitive and equity-indexed fixed annuities are investment risk and return. If a policyholder chooses a variable annuity, the rate of return will depend upon the performance of the underlying fund portfolio. The policyholder bears the investment risk except for fixed account options, where Jackson National Life guarantees a minimum fixed rate of return. In most cases, variable annuities also offer various types of elective enhanced death benefits, guaranteeing that on death the policyholder receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the highest past anniversary value of the policy, or as the original premium accumulated at a fixed rate of interest.

Jackson National Life credits premiums on variable annuities to a separate account. The policyholders determine how the premiums will be allocated by choosing to allocate all or a portion of their accounts either to a variety of variable sub-accounts, with a choice of investment managers, or to guaranteed fixed-rate options. The value of the portion of the separate account allocated to variable sub-accounts fluctuates with the underlying investment. Jackson National Asset Management, LLC, earns fee income as the investment adviser for the underlying funds and has retained the services of a number of other investment advisers to act as sub-advisers to Jackson National Life.

Variable annuity products are backed by specific assets that are held in a separate account. The assets in this separate account are legally "ring-fenced" and do not form part of the assets in the US general account, which backs the remainder of the insurance business in the United States. Amounts held in the separate account are not chargeable with liabilities arising out of any other business Jackson National Life may conduct. All of the income, gains or losses from these assets less specified management charges are credited to or against the policies and not any other policies that Jackson National Life may issue.

Jackson National Life earns fee income through the sale, investment and administration of the variable account options of variable annuity products. It also earns income on the spread between the interest credited on the fixed rate account and the investment income on the funds allocated to the accounts.

Life Insurance

Reflecting the competitive life insurance market place and the overall trend towards asset accumulation products, Jackson National Life's life insurance products accounted for less than 1% of the total new business premiums and 13% of policyholder reserves of US operations in

2001. The products offered include term life insurance and interest-sensitive life insurance. Each of these types of insurance policies can be modified using several options and riders to provide particular benefits, including waiver of premium, accidental death benefit, supplemental term insurance and guaranteed purchase options.

Stable Value Products

Stable value products are guaranteed investment contracts (GICs) and funding agreements. In 2001, stable value products accounted for 36% of total new business premiums and 20% of policyholder reserves of US operations. Jackson National Life began marketing GICs to institutional investors in December 1995. The GICs are marketed by its group pension 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. At December 31, 2001, Jackson National Life was a top ten provider of stable value business in terms of general account sales.

Four types of stable value products are offered:

- traditional GICs,
- funding agreements,
- medium term note funding agreements, and
- synthetic GICs.

Traditional Guaranteed Investment Contracts

Under a traditional GIC, the policyholder 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 pay outs. Jackson National Life tailors the scheduled pay outs to meet the liquidity needs of the particular retirement plan. If deposited funds are withdrawn earlier, an adjustment is made that approximates a market value adjustment.

Jackson National Life sells GICs to retirement plans, in particular 401(k) plans. The traditional GIC market is extremely competitive. This is due in part to competition from synthetic GICs.

Funding Agreements

Under a funding agreement, the policyholder either makes a lump-sum deposit or makes specified periodic deposits. Jackson National Life agrees to pay a rate of interest, which may be fixed but which is usually a floating short-term interest rate linked to an external index. Interest is paid quarterly to the policyholder. The average term for the funding agreements is one to two years. At the end of the specified term, policyholders typically re-deposit the principal in another funding agreement. Jackson National Life makes its profit on the spread between the yield on its investment and the interest rate credited to policyholders.

Typically, brokerage accounts and money market mutual funds are required to invest a portion of their funds in cash or cash equivalents to ensure sufficient liquidity to meet their customers' requirements. The funding agreements permit termination by the policyholder on 7 to 90 days notice, and thus qualify as cash equivalents for the clients' purposes. Funding agreements terminable by the policyholder with less than 90 days notice account for 0.7% of Jackson National Life's total policyholder reserves.

Medium-Term Note Funding Agreements

Jackson National Life has also established European and Global medium-term note programs that access new markets for Prudential. The notes offered may be denominated in any currency. Notes are issued to institutional investors by a special purpose vehicle and are secured by funding agreements issued by Jackson National Life.

Synthetic Guaranteed Investment Contracts

Under a synthetic GIC, the policyholder does not deposit any funds with Jackson National Life. Instead, the policyholder continues to own its plan assets and Jackson National Life agrees to guarantee that the plan will have sufficient liquid funds to meet its obligations to its participants.

This guarantee is provided for a fee. The event that could, in practice, cause a payment to be made under this guarantee would be an unexpected surge of withdrawals by scheme members at a time when asset values are depressed. This risk is mitigated through careful underwriting and through a number of features associated with these contracts, including controls on the plan's investments, requirements for "buffer funds" to absorb unexpected fluctuations in member withdrawals and, for most contracts, experience rating of the crediting rates granted to scheme members.

Jackson National Life sells its synthetic GICs to retirement plans primarily as an accommodation for its existing customers and therefore does not expect this business to grow much, if at all, beyond its current size. At December 31, 2001, Jackson National Life guaranteed £22 million ($31 million) of synthetic GICs. Because Jackson National Life does not own the assets underlying synthetic GICs, it does not recognize premium income or establish reserves, but it does recognize fee income.

Distribution and Marketing

Jackson National Life distributes products in all 50 states of the United States and in the District of Columbia, although not all products are available in all states. Operations in the State of New York are through a New York insurance subsidiary.

Jackson National Life has focused on independent distribution systems and has avoided the fixed costs associated with recruiting, training and maintaining employee agents. It supports its network of independent agents and brokers with education and training programs. A substantial portion of the costs associated with generating new business are not fixed costs but vary directly with the level of business produced. As a result, industry figures show that the costs are low relative to other US insurers.

In recent years Jackson National Life has been actively diversifying the methods by which it distributes its products. In part, this diversification of distribution reflected the strategy of product diversification. For instance, variable annuities can only be sold by registered broker-dealers and stable value products are targeted at institutions and direct plan sponsors and intermediaries acting on their behalf. Jackson National Life has developed and tailored its distribution capabilities accordingly.

Jackson National Life offers internet-based support to its broker-dealers. It continues to expand its internet-based services, increasing amounts of information available for both customers and agents.

Independent Agents

The insurance and fixed annuity products are distributed through independent agents located throughout the United States. These 40,000 licensed insurance agents or brokers, who also may represent other companies, are supported by eight regional marketing offices. Jackson National Life has continued to review its ranks of licensed agents during the year, actively identifying non-performing agents and not relicensing them. This initiative is aimed at improving Jackson National Life's ability to service its top agents and assist them in increasing their productivity. Jackson National Life generally deals directly with writing agents and brokers thereby eliminating intermediaries, such as general agents. This distribution channel, called "Deal Direct", has enabled it to generate significant volumes of business on a low, variable cost basis.

Jackson National Life is responsible for providing agents with product information and sales materials.

Broker-dealers

Jackson National Life Distributors, Inc., a broker-dealer, is the primary wholesale distribution channel for the variable annuity products. Jackson National Life Distributors also sells equity-indexed annuities and fixed annuities. An internal network of wholesalers supports this distribution channel. These wholesalers meet directly with broker-dealers and financial planners and are supported by an extensive home office sales staff. There are approximately 675 active selling agreements with regional and independent broker-dealer organizations throughout the United States. These selling agreements provide Jackson National Life with access to approximately 20,000 registered representatives.

In January 2002, Jackson National Life opened a new wholesale distribution channel servicing the regional broker-dealer distribution channel. Jackson National Life is well suited to provide the type of customized sales attention required for this channel. There will be an emphasis on providing dedicated, specialized sales support, continuing education and tailored marketing solutions.

In September 2000, Jackson National Life acquired IFC Holdings, Inc., which incorporated INVEST Financial Corporation and Investment Centers of America, Inc. Together with National Planning Corporation and SII Investments, Inc., Jackson National Life's existing broker-dealers, it has contracts with more than 2,300 registered representatives.

Jackson National Life is responsible for training its broker-dealers, providing them with product information and sales materials and monitoring their activities from a regulatory compliance perspective.

Banks, Credit Unions and Other Financial Institutions

Jackson National Life's Institutional Marketing Group distributes its annuity products through banks, credit unions and other financial institutions and through third-party marketing organizations that serve these institutions. Jackson National Life is a leading provider of annuities offered through banks and credit unions and works exclusively with more than 1,500 financial institutions, as well as all major third-party marketing organizations. Jackson National Life has established distribution relationships with medium-sized regional banks, which it believes are unlikely to develop their own insurance product capability.

Group Pension Department

Jackson National Life markets its stable value products through its group pension department. It has direct contacts with banks, municipalities, asset management firms and direct plan sponsors. Stable value products are distributed and marketed through intermediaries to these groups.

Factors Affecting Pricing of Products and Asset Liability Management

Jackson National Life prices products based on assumptions about future mortality, investment yields, expenses and persistency. Pricing is influenced by competition and by its objectives for return on capital. Although Jackson National Life 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 it was assumed they would be. This variation can be significant.

Jackson National Life 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, whole life, universal life and guaranteed investment contract product obligations. Jackson National Life 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 and in options to match the equity-related returns under its equity-indexed products.

Jackson National Life segregates its investment portfolio for certain investment management purposes and as part of its overall investment strategy into four parts: annuity without market value adjustment, fixed annuity with market value adjustment, equity-indexed annuities and stable value liabilities. The portfolios backing fixed annuities with and without market value adjustments have similar characteristics and differ primarily in duration. The portfolio backing the stable value liabilities has its own mix of investments that meet more limited duration tolerances. Consequently the stable value portfolio is managed to permit less interest rate sensitivity and limited exposure to mortgage-backed securities. At December 31, 2001, less than 6% of the stable value 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. At December 31, 2001, approximately 73% of Jackson National Life's fixed annuity reserves had surrender penalties or other withdrawal restrictions. Substantially all of the stable value portfolio had withdrawal restrictions or market value adjustment provisions.

Underwriting

The decision to underwrite a particular life policy depends upon the assessment of the risk to Jackson National Life represented by the proposed policy. The risk selection process is performed by the underwriters who evaluate policy applications on the basis of information provided by the applicant and other sources. Specific medical tests may be used to evaluate policy applications based on the size of the policy, the age of the applicant and other factors.

Jackson National Life's underwriting rules and procedures are designed to produce mortality results consistent with the assumptions used in product pricing while providing for competitive risk selection.

Reserves

Jackson National Life uses reserves established on a US GAAP basis as the basis for consolidation into Prudential's UK GAAP accounts.

For the fixed and variable annuity contracts and stable value products, the reserve is the policyholder's account value. For the immediate annuities, reserves are determined as the present value of future policy benefits. Mortality assumptions are based on the 1983a Individual Annuitant Mortality Table. Interest rate assumptions currently range from 4.9% to 7.5%.

For the traditional term life contracts, reserves for future policy benefits are determined using the net level premium method and assumptions as to mortality, interest, policy persistency and expenses. Mortality assumptions are primarily based upon the 1975-1980 Basic Select and Ultimate tables, and range from 50% to 90%, depending on underwriting classification and policy duration. Interest rate assumptions range from 6.0% to 9.5%. Persistency and expense assumptions are based on experience.

For the interest-sensitive life reserves and single premium life reserves, reserves approximate the policyholder's accumulation account.

Reinsurance

Jackson National Life reinsures portions of the coverage provided by its insurance products with other insurance companies under agreements of indemnity reinsurance. Reinsurance assumed from other companies is not material.

Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to obtain a greater diversification of risk for the life insurer. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured. Jackson National Life's reinsured business is ceded to numerous reinsurers and the amount of business ceded to any one reinsurer is not material. Typically, the reinsurers have a rating of A or higher.

Jackson National Life limits the amount of risk it retains on new policies. Currently, the maximum risk that is retained on new policies is $1.0 million ($1.5 million on last survivor life business). Jackson National Life is not a party to any risk reinsurance arrangement with any reinsurer pursuant to which the amount of reserves on reinsurance ceded to such reinsurer equals more than 1% of total policy reserves.

Beginning in late 1995, Jackson National Life entered into reinsurance agreements to cede 80% of its new level premium term life insurance business written in the United States to take advantage of competitive pricing in the reinsurance markets. Beginning January 1, 1999, it began to cede 90% of new writings of level premium term products. Jackson National Life intends to continue to cede a significant proportion of new term life insurance business for as long as pricing in the reinsurance markets remains favorable.

Policy Administration

Jackson National Life provides a high level of administrative support for both new and existing policyholders. Jackson National Life's ability to implement new products quickly and provide customer service is supported by integrated computer systems that propose, issue and administer complex life-insurance and annuity contracts. Jackson National Life continues to develop its life insurance administration and underwriting systems and its fixed and variable annuity administration systems to enhance the service capabilities for both new and existing policies.

Jackson Federal Bank

Prudential further diversified its business in the United States through the purchase in 1998 of a federally chartered savings association, First Federal Savings and Loan Association of San Bernardino, which is now called Jackson Federal Bank. The addition of a federally chartered savings association has resulted in an expanded product range in the United States and is expected to give Jackson National Life the option to roll out a wider range of banking products including loans, checking accounts and credit cards. In 2000, Jackson National Life further expanded its banking operations in the United States. In February 2000, Jackson National Life announced the acquisition of three Fidelity Federal Branches and in September 2000, Jackson National Life acquired Highland Bancorp Incorporated, the holding company for Highland Federal Bank, for $110 million. Highland Federal Bank and the three Fidelity Federal Branches were merged with and renamed as Jackson Federal Bank. As at December 31, 2001, assets totaled $1,426 million.

Jackson Federal Bank, through its 14 retail branch offices located throughout the counties of Los Angeles, Orange and San Bernardino in Southern California, attracts deposits which together with borrowings and other funds provide loans secured by real estate and, to a lesser extent, purchase real estate related investment securities. Deposit accounts at December 31, 2001 totaled $837 million (£575 million).

Jackson Federal Bank's asset growth is primarily derived from loans originated through four loan offices, and to a lesser extent loan purchases. As at December 31, 2001 loans receivable totaled $1,012 million (£696 million).

PPM America

PPM America is Prudential's US fund management operation, with offices in Chicago and New York. Its primary focus is to manage funds for Jackson National Life and therefore the majority of funds under management are fixed interest in nature. PPM America has developed expertise in managing credit risk and has increasingly invested its funds in higher credit risk investments. Recently, PPM America has launched a number of institutional high yield and special investment vehicles to leverage these capabilities into new profitable areas.

Asian Business

Prudential is Europe's leading life insurer in Asia. Only six years ago, Prudential's Asian presence was confined to Singapore, Hong Kong and Malaysia. Today, Prudential has a very strong regional presence with 21 operations in 12 countries, including top five market positions in eight of those operations (six in its life businesses and two in mutual funds).

Development of Prudential's Asian Business

Prudential's Asian operations are managed by its Hong Kong-based regional head office. Prudential's operations in Asia date from 1923, when it opened a branch office in India, which served the Indian sub-continent and several Middle Eastern countries with historic ties to the United Kingdom. In 1924, Prudential opened a branch office in Malaysia. Prudential expanded into Singapore in 1931 and opened a branch office in Hong Kong in 1964. In 1956, Prudential's Indian operations were nationalized and, in 1984, the Malaysian government required Prudential to sell a majority interest in its Malaysian operations to a local company. Prudential began expanding again in Asia during the mid-1990s, establishing operations in Thailand, The Philippines and Indonesia. In 1998, Prudential re-entered the Indian market via a joint venture mutual fund operation. In 1999, Prudential entered Taiwan with the acquisition of a life insurance company and launched a greenfield life operation in Vietnam. In 2000, Prudential acquired a mutual fund company in Taiwan and launched greenfield life insurance operations in China and India.

During 2001, Prudential continued its geographic expansion with the acquisition of Orico Life in Japan and YoungPoong Life in South Korea. Both of these operations have been re-branded PCA Life and Prudential is now building on these operationally and financially sound platforms. Prudential intends, in time, to gain significant market share in these countries, Asia's two largest life insurance markets. In addition, Prudential acquired Allstate's operations in Indonesia and The Philippines during 2001.

Prudential's success in Asia derives from a unique combination of competitive advantages including its ability to invest for the long-term, an extensive understanding of local markets and their people, considerable experience of overcoming barriers to entry into new markets, and its ability to leverage the power and financial strength of Prudential's brand.

Historically, Prudential's local agent salesforces have been its primary distribution channel and in 2001 it continued to achieve strong growth in sales through this channel. In addition, Prudential achieved strong growth through other distribution channels, including bancassurance and direct distribution, which together generated just over 16% of total new business insurance premiums, a significant increase on 2000. Prudential now has bank distribution agreements in place in nine countries in Asia.

PPM Asia, Prudential's Asian fund management operation, has offices in Singapore, Hong Kong and Tokyo. At December 31, 2001, PPM Asia had £8.3 billion of funds under management. In addition Asia's mutual funds operations had £3.1 billion of funds under management at December 31, 2001.

In line with Prudential's strategy of expanding its successful unit trust operations across the region, it launched Prudential Unit Trusts in both Malaysia and Singapore during 2001. These operations supplement Prudential's already successful and fast-growing mutual fund operations in India (ranked second by assets under management), Taiwan (ranked fourth by assets under management), and Japan.

Hong Kong's Mandatory Provident Fund had its first full year of operation in 2001 and Prudential's joint venture with Bank of China International is now one of the market leaders in this market with an estimated 15% market share. In December 2001, BOCI-Prudential also launched its first unit trust in Hong Kong.

New Business Premiums

Prudential experienced another year of strong growth in Asia in 2001. This was despite the anticipated slowdown in life insurance new business growth during the fourth quarter, as the global economic slowdown started to have an effect on the region. Sales of insurance products were £1,019 million in 2001, up 102% from 2000.

The following table shows Prudential's Asian life insurance new business premiums and UK GAAP policyholder reserves by territory for the periods indicated. In this table "Other Countries" includes China, India, Thailand, Indonesia, South Korea, The Philippines, and Vietnam. The 1999 result includes two months of operations in Taiwan, acquired in 1999. Results for 2001 includes the post-acquisition results of Japan and South Korea.

	Year Ended December 31, 2001	2000	1999	Policyholder Reserves At December 31, 2001
	(In £ Millions)			
Singapore	**552**	285	192	**2,405**
Hong Kong	**159**	62	44	**780**
Malaysia	**58**	47	35	**357**
Taiwan	**140**	79	5	**632**
Japan	**40**			**630**
Other countries	**70**	31	13	**128**
Total	**1,019**	504	289	**4,932**

In addition, for the year ended December 31, 2001, Prudential mutual funds had funds under management of £3.1 billion, up from £1.6 billion in 2000 following net sales of £1.5 billion during the year (up from £0.3 billion in 2000).

Products

The savings and protection products offered in Asia are generally similar to the products offered in the United Kingdom and include with-profits, non-participating and, in some countries, unit-linked products. However, unlike the United Kingdom, where savings products predominate, Prudential's business in Asia is more balanced between savings and protection products. In 2001, with-profits products accounted for 31% of Asia's total new business insurance premiums.

Prudential offers debt, equity and money market mutual fund investment products in India, Taiwan, Hong Kong, Japan, Singapore and Malaysia.

In Hong Kong, Prudential's life insurance business is supplemented by personal lines property and casualty insurance products which had total gross premiums of £17 million in 2001.

Singapore

Prudential established its operations in Singapore in 1931 and conducts them through Prudential Assurance Company Singapore (Pte) Limited, a wholly-owned subsidiary of The Prudential Assurance Company Limited. In 2001, Prudential was the fourth-largest life insurer in Singapore in terms of new single premiums and the second-largest in terms of new regular premium business. In 2001, Prudential's Singapore operation contributed 54% of total Asian life insurance new business premiums.

Twelve companies are authorized to operate in the life insurance market in Singapore. Five companies account for over 90% of the market in terms of new annual premium equivalents. The Monetary Authority of Singapore closely regulates this mature and highly competitive market. In 1999, insurance penetration was estimated to be 76% in a country of 3.2 million people.

Singapore has a Central Provident Fund in which each employed individual has an account in which he or she is obliged to make contributions from their salary. In addition employers are obliged to make contributions to their employees' accounts.

The Central Provident Fund was liberalized in January 1997 and participants were permitted to use a greater proportion of their funds to purchase authorized insurance, pension and other regulated products. The fund was further liberalized in the first half of 2001 and as a result, single premium business volumes increased for the Singapore life insurance industry generally in 2001. This liberalization was an exceptional event that resulted in increased single premium business volumes for Prudential during the year.

The products Prudential offers in Singapore include a range of with-profits and non-participating term, whole life and endowment life insurance policies and unit-linked products. Prudential also offers health, critical illness and accident cover as supplements to its life products. In 1993 Prudential was the first life insurance company to introduce unit-linked products to the Singapore market.

Prudential distributes its products in Singapore primarily through its local agent salesforce. In 1999 Prudential began distributing products through consultants based in branches of Standard Chartered Bank.

Hong Kong

Prudential's Hong Kong operations are conducted through a branch office of The Prudential Assurance Company Limited. Prudential opened its branch in 1964 writing property and casualty insurance. It operates in a competitive and relatively mature market. According to the Hong Kong Office of the Commissioner of Insurance's annual report for 2000, in 1999 insurance penetration was approximately 63% in a country of 6.8 million people. In 2001, Prudential was the third-largest life insurer in Hong Kong in terms of new regular premium business.

As from December 1, 2000, employees, employers and the self-employed became obliged to make contributions to the Mandatory Provident Fund (MPF). The plans that comprise the MPF are defined contribution pension plans with immediate vesting, preservation until retirement (or some other event specified by legislation) and full portability. Individuals are required to make mandatory contributions of 5% of salary and employers make contributions equal to 5% of the employee's salary to the individual's accounts in the Fund. Both employee and employer contributions are subject to a maximum amount, currently HK$1,000 per month. Additional voluntary contributions are possible.

During 1999, Prudential entered into a joint venture with Bank of China International (BOCI) to serve the Hong Kong MPF. Prudential's joint venture with BOCI (in which Prudential has a 36% interest) provides Prudential with access to the MPF market in Hong Kong through one of the largest retail bank branch networks in Hong Kong. The joint venture achieved an estimated 15% market share in 2001 with Prudential's share of total MPF contributions reaching £91 million.

Prudential offers both individual and group products in Hong Kong, including life insurance, health insurance and pensions. The individual life insurance products offered include with-profits products, unit-linked products and other non-participating products, together with accident and critical illness policies. The property and casualty insurance Prudential writes in Hong Kong is primarily personal lines, with a small book of commercial business.

Prudential's products in Hong Kong are distributed primarily through its local agent salesforce. In April 1999, Prudential began marketing and distributing products to customers of Standard Chartered Bank.

Malaysia

Prudential's Malaysian office opened in 1924 as a branch of The Prudential Assurance Company Limited. Prudential began writing life insurance there in 1931. In 2001, Prudential ranked second in Malaysia in terms of new regular premium business. There are 17 licensed life insurance companies in Malaysia covering a market of 24 million people.

The products Prudential offers in Malaysia are linked products, with-profits products and non-participating products and include whole life, health insurance and accident and critical illness cover products.

Prudential introduced unit-linked products to the Malaysian market. In 1997, Prudential was the first company to offer single-premium unit-linked products and, in August 1999, it was the first company to offer a regular-premium unit-linked product.

Prudential distributes its products in Malaysia mainly through its local agent salesforce. In 2000, Prudential extended its bancassurance agreement with Standard Chartered Bank into Malaysia.

Taiwan

In late 1999, Prudential acquired a 74% interest in Chinfon Life Insurance Company Limited, a Taiwanese Life insurance company. Prudential's ownership had increased to 95% as of December 31, 2001.

In 2001, Prudential's Taiwanese operation was its third largest Asian operation in terms of total new business insurance premiums and was ranked eighth in the Taiwan market in terms of first year individual life premiums. Taiwan had a population of 22 million people in 2001.

The products Prudential offers in Taiwan are unit-linked products and non-participating products and include whole life, health insurance and accident and critical illness cover products. Regulatory changes have taken place including the introduction of unit-linked products and Prudential was the first company to launch these with a single premium product in late 2001 and a regular premium product in January 2002.

Distribution has been mainly through Prudential's local agent salesforce and partly through brokers and bancassurance.

In October 2000, Prudential acquired an 89% interest in a Taiwanese mutual fund company, renamed Prudential Securities Investment Trust Enterprise (Prudential SITE). This company was established in 1992 and at December 31, 2001 was the fourth largest unit trust company in Taiwan in terms of funds under management. As at December 31, 2001, Prudential had increased its stake to 99.5%. Its product range includes equity and bond funds and funds under management at December 31, 2001 were £2 billion.

Japan

In February 2001, Prudential acquired Orico Life in Japan, an operationally and financially sound modern Japanese life insurance company, for £139 million including expenses. Orico Life, established in 1990, is based in Tokyo and has operations in a further ten locations in Japan. The company was relaunched as PCA Life in July 2001. PCA Life offers a range of products including term, savings and protection products and uses a multi-channel distribution system including professional agents, financial institutions and accountants. In 2001, Japan had a population of 127 million.

China

Prudential has a license to write life insurance in the city of Guangzhou in China. During 1999, Prudential formed a venture with the China International Trust & Investment Company to write life insurance policies under this license and in October 2000 its life insurance operation in China was officially launched. As of December 31, 2001, only two other foreign companies offered life insurance products in the city of Guangzhou. Guangzhou had a population of approximately ten million people in 2001.

In China, Prudential offers unit-linked products, with-profits products and non-participating products including whole life, endowment and accident and health products. During 2001, Prudential became the first foreign life insurance company to sell unit-linked life insurance policies in Guangzhou. Distribution has been predominantly through Prudential's local agent salesforce.

India

Prudential re-entered the Indian market in 1998 through a joint arrangement with The Industrial Credit and Investment Corporation of India (ICICI), a leading Indian financial services company. As at December 31, 2001, Prudential ICICI Asset Management Company Limited was the largest private sector mutual fund company in the country. Prudential's shareholding of the mutual fund operation stood at 55% at the end of 2001. Funds under management at December 31, 2001 were £1.1 billion.

Prudential distributes its investment products in India through brokers and bank branches, and primarily through its local agent salesforce. The broker channel has been Prudential's primary distribution channels to date, accounting for more than 80% of its gross sales in 2001.

Following the Insurance Regulatory and Development Authority Act passed by the Indian government, ICICI Prudential Life Insurance (in which Prudential has a 26% interest) received a license from the Insurance Regulatory and Development Authority and commenced life insurance operations in India in November 2000. In 2001, India's population exceeded one billion people.

South Korea

In October 2001, Prudential acquired 100% of YoungPoong Life, a multi-distribution based Korean life insurance company for £23 million including expenses. Established in 1989, YoungPoong Life is based in Seoul and has branches in a further two locations in Korea. It had total assets as at December 31, 2001 of over W100 billion (£53million). It offers a range of products including term, savings and protection products. Distribution is multi-channel and includes general agents, exclusive agents and a telemarketing operation. In February 2002, it was relaunched as PCA Life. In 2001, South Korea had a population of 48 million.

Thailand, Indonesia, The Philippines and Vietnam

Prudential also has life insurance operations in Thailand, Indonesia, The Philippines and Vietnam where Prudential's primary distribution channel is its local agent salesforces. In Vietnam, Prudential was the first foreign wholly-owned company with a license to sell life insurance. Prudential is one of only five companies licensed to write life insurance in Vietnam. In June 2001, Prudential completed its acquisition of

Allstate's life operations in Indonesia and The Philippines.

European Business

In November 1999, Prudential announced the formation of Prudential Europe, a new business segment formed to implement its strategy in continental Europe. Prudential's European operations encompass both the manufacture and distribution of products under the Prudential and Scottish Amicable brands into continental Europe through Prudential's existing operations and strategic distribution arrangements into which Prudential has entered and into which it aims to enter in the future.

Germany

The products offered in Germany include unit-linked pension and protection products marketed by Scottish Amicable Life International, an Irish company that has the benefit of tax advantages applicable to offshore companies. Prudential achieved an estimated 2% market share of that business in 2001. Prudential distributes its products in Germany through its local agent salesforce.

In 2001, Prudential launched two mutual fund products (Dachfonds) in co-operation with DWS, a third-party provider.

France

In January 2001, Prudential launched Prudential Europe Vie, an equity-backed life insurance product that offers a choice of investment through the Prudential life fund or Réactif, a unit-linked fund provided by Véga Finance. The product is initially being sold through independent financial advisers approved by Centre Français du Patrimoine, a subsidiary of Crédit Foncier de France and the largest multi-brokerage network in France.

In 2002, Prudential launched a similar arrangement with Espace Patrimoine Conseil, a subsidiary of Crédit Mutuel de Bretagne, and is expecting to enter into further arrangements later in the year.

Prudential has continued to co-operate with CNP Assurance, the largest distributor of financial products in France, with whom it entered into a memorandum of understanding in 1999.

Investments

General

The overall financial strength of the Prudential group and the results, both current and future, of the insurance business are in part dependent upon the quality and performance of the various investment portfolios in the United Kingdom, the United States, Asia and in Europe.

Prudential's Total Investments

The following table shows Prudential's insurance and non-insurance investments at December 31, 2001. The "Other" column includes central funds, a short-term fixed income securities reinvestment program and funds in respect of other non-insurance operations. Assets held to cover linked liabilities relate to unit-linked and variable annuity products. In this table, investments are valued as set out in Note 3 of the notes to Prudential's consolidated financial statements.

At December 31, 2001

Insurance						Banking	
United Kingdom	United States	Asia	Europe	Other	Sub-total	United Kingdom and United States	Total

	At December 31, 2001							
	(In £ Millions)							
Other financial investments								
Debt and other fixed income securities	**33,913**	**21,843**	**2,432**	**20**	**973**	**59,181**	**3,253**	**62,434**
Equity securities	**39,870**	**186**	**825**	**28**	**39**	**40,948**	**13**	**40,961**
Loans and other	**3,268**	**4,614**	**722**	**44**	**551**	**9,199**	**5,475**	**14,674**
Total other financial investments	**77,051**	**26,643**	**3,979**	**92**	**1,563**	**109,328**	**8,741**	**118,069**
Real estate								
Investment	**10,153**	**22**	**78**		**1**	**10,254**		**10,254**
Company-occupied	**129**	**42**	**47**		**15**	**233**	**12**	**245**
Total real estate	**10,282**	**64**	**125**		**16**	**10,487**	**12**	**10,499**
Sub-total	**87,333**	**26,707**	**4,104**	**92**	**1,579**	**119,815**	**8,753**	**128,568**
Participating interests			**28**		**59**	**87**		**87**
Total investments	**87,333**	**26,707**	**4,132**	**92**	**1,638**	**119,902**	**8,753**	**128,655**
Assets held to cover unit-linked liabilities	**12,491**	**3,522**	**857**	**583**		**17,453**		**17,453**
Total	**99,824**	**30,229**	**4,989**	**675**	**1,638**	**137,355**	**8,753**	**146,108**

Prudential's Investment Yields

The following table shows the income from the investments of Prudential's continuing operations by asset category for the periods indicated. This table does not include investment income from unit-linked and variable annuity products, or from banking investments. Yields have been calculated using the average of opening and closing balances for the appropriate asset.

	Year Ended December 31,					
	2001		2000		1999	
	Yield	Amount	Yield	Amount	Yield	Amount
	(In £ Millions, Except Percentages)					
Debt and other fixed income securities						
Net investment income	**7.0%**	**3,746**	7.4%	3,264	7.1%	2,732
Net realized investment gains	**0.7%**	**369**	1.2%	533	0.6%	212
Net unrealized investment (losses) gains	**(1.1)%**	**(588)**	(1.6)%	(717)	(4.1)%	(1,571)
Ending assets		**59,181**		48,594		39,833
Equity investments						
Net investment income	**2.5%**	**1,132**	2.3%	1,268	2.7%	1,451

	Year Ended December 31,					
Net realized investment gains	**4.6%**	**2,122**	11.1%	6,022	8.2%	4,368
Net unrealized investment (losses) gains	**(18.4)%**	**(8,475)**	(13.1)%	(7,146)	11.3%	6,024
Ending assets		**40,948**		51,232		57,693
Loans and other						
Net investment income	**8.7%**	**758**	8.7%	721	8.3%	629
Net realized investment (losses) gains	**(0.0)%**	**(3)**	0.0%	4	0.4%	30
Net unrealized investment (losses) gains	**(0.8)%**	**(74)**	1.0%	87	0.0%	1
Ending assets		**9,199**		8,299		8,341
Real estate						
Net investment income	**7.3%**	**764**	7.5%	716	7.7%	617
Net realized investment gains	**2.8%**	**288**	1.5%	143	1.3%	103
Net unrealized investment (losses) gains	**(2.0)%**	**(206)**	3.9%	369	7.8%	627
Ending assets		**10,487**		10,303		8,763
Total (excluding unit-linked and cash)						
Net investment income	**5.4%**	**6,400**	5.1%	5,969	5.1%	5,429
Net realized investment gains	**2.3%**	**2,776**	5.8%	6,702	4.4%	4,713
Net unrealized investment (losses) gains	**(7.8)%**	**(9,343)**	(6.4)%	(7,407)	4.7%	5,081
Ending assets		**119,815**		118,428		114,630

Prudential's Insurance Investment Strategy and Objectives

Prudential's insurance investments support a range of businesses operating in many geographic areas. Each of the operations formulates a strategy, based on the nature of its underlying liabilities, its level of capital and its local regulatory requirements. Where the nature of underlying liabilities, level of capital and local regulatory requirements permit, Prudential tends to invest its assets predominantly in equities and real estate that have, over longer periods, provided superior returns to fixed interest assets.

Management of Insurance Funds

Except for a small amount of unit-linked business and variable annuity business, amounting to approximately 4% of Prudential's own funds under management at December 31, 2001, Prudential manages its insurance funds principally through its fund management businesses, M&G in the United Kingdom, together with PPM America in the United States and PPM Asia in Singapore, Hong Kong and Japan.

In each of the operations, local management analyzes the liabilities and determines asset allocation, benchmarks and permitted deviations from these benchmarks appropriate for its operation. These benchmarks and permitted deviations are agreed with internal fund managers, who are responsible for implementing the specific investment strategy through its local fund management operations.

Investments Relating to UK Insurance Business

Strategy

In the United Kingdom, Prudential tailors its investment strategy for long-term business, other than unit-linked business, to match the type of product a portfolio supports. The primary distinction is between with-profits portfolios and non-participating portfolios, which include the majority of annuity portfolios. Generally, the objective is to maximize returns while maintaining investment quality and asset security and adhering to the appropriate government regulations.

With-profits contracts are long-term contracts with minimal guaranteed amounts, the nature of which permits Prudential to invest primarily in equities and real estate. Accordingly, the with-profits fund investment strategy emphasizes a well-diversified equity portfolio (containing some international equities), UK real estate, UK and international fixed income securities and cash.

For Prudential's UK pensions annuities business and other non-participating business the objective is to maximize profits while ensuring stability by closely matching the cashflows of assets and liabilities. To achieve this matching, the strategy is to invest in fixed income securities of appropriate maturity dates.

For Prudential's unit-linked business, the primary objective is to maximize investment returns subject to following an investment policy consistent with the representations Prudential has made to its unit-linked product policyholders.

Prudential's property and casualty business was discontinued in January 2002. This business had investment requirements that differed from long-term insurance business. This was because property and casualty insurance liabilities tended to have a shorter duration than long-term insurance liabilities and because shareholder funds bore all of the investment risk on this business. As a result, the portfolio had a higher component of investments in fixed income securities than the with-profits fund to match the mean term of the liabilities and to reduce volatility. However, Prudential invested in equities to the extent that there was sufficient capital to absorb the volatility. Prudential's property and casualty business investment strategy was designed to maximize after-tax return while maintaining appropriate liquidity and capital levels. Since the disposal of the business in January 2002, the related investments have been absorbed into central funds.

Investments

The following table shows the investments relating to Prudential's UK insurance business, other than its unit-linked business, at December 31, 2001. In this table, investments are shown at market value. The with-profits fund also includes two other businesses, SAIF and Prudential Annuities Limited. The investments in respect of SAIF are shown separately. The investments in respect of Prudential Annuities Limited are included within the Annuities column. The investments attributed to property and casualty business have been absorbed into central funds since the disposal of that business in January 2002. The "Other" column includes investments relating to solvency capital of unit-linked funds and investments relating to non-life, long-term business.

	At December 31, 2001						
	With-Profits	Annuities	SAIF	Property and Casualty	Other	Total	Total %
	(In £ Millions, Except Percentages)						
Equity securities							
United Kingdom							
Listed	23,537		4,658	224	3	28,422	
Unlisted	80		1	21		102	
Total United Kingdom	23,617		4,659	245	3	28,524	32.7
International							
United States	2,793		562	14		3,369	
Europe (excluding the United Kingdom)	2,722		554			3,276	
Japan	1,073		204	2		1,279	
Pacific (excluding Japan)	1,967		393			2,360	
Other	796		266			1,062	
Total international	9,351		1,979	16		11,346	13.0
Total equity securities	32,968		6,638	261	3	39,870	45.7
Debt and other fixed income securities							
UK government	203	473	57	41	100	874	
US government				55		55	
Other	17,116	10,058	5,477	37	296	32,984	
Total fixed income securities	17,319	10,531	5,534	133	396	33,913	38.8
Real estate							

	At December 31, 2001						
Investment property	**8,472**	**186**	**1,495**			**10,153**	
Company-occupied property	**129**					**129**	
Total real estate	**8,601**	**186**	**1,495**			**10,282**	**11.8**
Loans and other							
Loans	**90**	**299**	**177**		**3**	**569**	
Deposits	**1,959**	**57**	**143**	**124**	**416**	**2,699**	
Total loans and other	**2,049**	**356**	**320**	**124**	**419**	**3,268**	**3.7**
Total	**60,937**	**11,073**	**13,987**	**518**	**818**	**87,333**	**100.0**

Equity Securities

Prudential's UK insurance operations, excluding unit-linked business, had £39,870 million invested in equities at December 31, 2001. Most of these equities support Prudential Assurance's with-profits fund and the SAIF fund, both of which are managed using the same general investment strategy. The following table shows the geographic spread of this equity portfolio by market value.

	At December 31, 2001	
	Market Value	**%**
	(In £ Millions, Except Percentages)	
United Kingdom	**28,524**	**71.5**
United States	**3,369**	**8.5**
Europe (excluding United Kingdom)	**3,276**	**8.2**
Japan	**1,279**	**3.2**
Pacific (excluding Japan)	**2,360**	**5.9**
Other	**1,062**	**2.7**
Total	**39,870**	**100.0**

The UK equity holdings are well diversified and broadly mirror the FTSE All-Share Index. Prudential holds equities in more than 600 UK companies. At December 31, 2001, the ten largest holdings in UK equities amounted to £13,764 million, accounting for 48.3% of the total UK equity holdings of £28,524 million supporting the UK insurance operations. The following table shows the market value of the ten largest holdings in UK equities at December 31, 2001.

	At December 31, 2001	
	Market Value	**%**
	(In £ Millions, Except Percentages)	
Vodafone Group	**2,370**	**8.3**
B.P.	**2,368**	**8.3**
Glaxo Smith Kline	**2,155**	**7.6**

	At December 31, 2001	
HSBC Holdings ORD	**1,481**	**5.2**
Astra Zeneca	**1,107**	**3.9**
Shell Transport and Trading	**1,001**	**3.5**
Barclays	**925**	**3.3**
Lloyds TSB Group	**868**	**3.0**
The Royal Bank of Scotland Group	**865**	**3.0**
Diageo	**624**	**2.2**
Total	**13,764**	**48.3**

All industry sectors are represented in Prudential's equity portfolio. At December 31, 2001, within the £28,524 million in UK equities supporting the UK insurance operations, Prudential had £20,914 million, or 73.3% of the holdings invested in ten industries. The following table shows the primary industry concentrations based on market value of the portfolio of UK equities relating to the UK insurance business at December 31, 2001.

	At December 31, 2001	
	Market Value	**% of UK Equity Holdings**
	(In £ Millions, Except Percentages)	
Banks	**5,424**	**19.0**
Oil and Gas	**3,634**	**12.8**
Pharmaceuticals	**3,428**	**12.0**
Telecommunication Services	**3,304**	**11.6**
Media and Photography	**1,317**	**4.6**
General Retailers	**873**	**3.1**
Beverages	**774**	**2.7**
Investment Companies	**742**	**2.6**
Leisure, Entertainment and Hotels	**727**	**2.5**
Mining	**691**	**2.4**
Total	**20,914**	**73.3**

Debt and Other Fixed Income Securities

At December 31, 2001, 82.8% of Prudential's fixed income securities supporting the UK insurance operations were issued by corporations, 2.6% were issued or guaranteed by the UK government, 0.2% were issued or guaranteed by the US government and 12.7% were issued or guaranteed by other overseas governments. These guarantees relate only to payment and, accordingly, do not provide protection against fluctuations in market price that may occur during the term of the fixed income securities. The remaining 1.7% of Prudential's fixed income securities supporting the UK insurance operations consists mainly of local UK government issues.

The following table shows the market value of the fixed income securities portfolio by maturity at December 31, 2001.

	At December 31, 2001	
	Market Value	**%**
	(In £ Millions, Except Percentages)	

	At December 31, 2001	
Securities maturing:		
within one year	**645**	**1.9**
over one year and up to five years	**4,913**	**14.5**
over five years and up to ten years	**10,148**	**29.9**
over ten years and up to fifteen years	**4,058**	**12.0**
over fifteen years	**14,149**	**41.7**
Total	**33,913**	**100.0**

Approximately 67.0% of the fixed income securities portfolio was rated by Standard & Poor's at December 31, 2001, of which 19.4% was rated AAA, 7.5% was rated between AA- and AA+, 20.0% was rated between A- and A+, 16.6% was rated between BBB- and BBB+ and 3.5% was rated below BBB-. A further 9.9% of this portfolio was rated by Moody's Investors Services at December 31, 2001, of which approximately 2.5% was rated Aaa, 2.6% was rated between Aa1 and Aa3, 2.3% was rated between A1 and A3, 1.3% was rated between Baa1 and Baa3 and 1.2% was rated below Baa3.

Real Estate

At December 31, 2001, Prudential's UK insurance operations had £10,282 million of investments in real estate in the United Kingdom. The following table shows the real estate portfolio by type of investment. The real estate investments are shown at market value in accordance with the policies described in Note 3 of the notes to the consolidated financial statements.

	At December 31, 2001	
	Market Value	%
	(In £ Millions, Except Percentages)	
Office buildings	**4,077**	**39.7**
Shopping centers/commercial	**4,459**	**43.4**
Retail warehouses/industrial	**1,585**	**15.4**
Development	**137**	**1.3**
Other	**24**	**0.2**
Total	**10,282**	**100.0**

59.0% of the UK real estate investments are located in London and Southeast England with the remaining 41.0% located throughout the rest of the United Kingdom.

Loans and Other

At December 31, 2001, the loans and other portfolio of the UK insurance operations amounted to £3,268 million. The following table shows the loans and other portfolio by value at December 31, 2001.

	At December 31, 2001
	(In £ Millions)
Loans collateralized by mortgages	**381**
Loans to policyholders collateralized by insurance policies	**89**
Other loans	**99**

	At December 31, 2001
Deposits with credit institutions	2,445
Other	254
Total	3,268

Investments Relating to US Insurance Business

Strategy

Jackson National Life's investment strategy, for business other than its variable annuity business, is to maintain a diversified and largely investment grade debt and fixed income securities portfolio that maintains a desired investment spread between the yield on the portfolio assets and the rate credited on policyholder liabilities. Interest rate scenario testing is continually used to monitor the effect of changes in interest yields on cash flows, the present value of future profits and interest rate spreads.

Jackson National Life's investment portfolio consists primarily of fixed income securities, although the portfolio also contains investments in mortgage loans, policy loans, common and preferred stocks, cash and short-term investments and miscellaneous other investments.

Investments

The following table summarizes Jackson National Life's total insurance investments other than the investments supporting its variable annuity business at December 31, 2001.

	December 31, 2001			
	Non-Stable Value	Stable Value	Total	Total %
	(In £ Millions, Except Percentages)			
Other financial investments				
Debt and other fixed income securities				
Corporate securities and commercial loans	10,151	4,149	14,300	53.5
Residential mortgage-backed securities	5,109	341	5,450	20.4
Commercial mortgage-backed securities	586	415	1,001	3.8
Other	607	485	1,092	4.1
Total debt and other fixed income securities	16,453	5,390	21,843	81.8
Loans and other	4,327	287	4,614	17.3
Equity securities	174	12	186	0.7
Total other financial investments	20,954	5,689	26,643	99.8
Real estate	52	12	64	0.2
Total	21,006	5,701	26,707	100.0

Debt and other fixed income securities are shown at amortized cost, with the exception of certain securities held by the US fund management operation, which are shown at market value. Loans and other, equity securities, and real estate are shown at market value, with the exception of interests in associate undertakings (included in equity securities). Interests in associate undertakings are carried at Jackson National Life's proportionate share of net assets. The market value of unlisted securities is estimated by Jackson National Life, using independent pricing services or analytically determined values.

Debt and Other Fixed Income Securities

Corporate Securities and Commercial Loans

At December 31, 2001, Jackson National Life had £14,300 million of corporate securities and commercial loans, representing 53.5% of US insurance total investments. Of the £14,300 million, £11,241 million consisted of publicly traded and Rule 144A fixed income securities and £3,059 million consisted of investments in non-Rule 144A privately placed fixed income securities.

The following table shows the credit quality of the portfolio of publicly traded and Rule 144A fixed income securities at December 31, 2001.

	At December 31, 2001	
	Book Value	% of Total
	(In £ Millions, Except Percentages)	
NAIC Designation		
1	**3,320**	**29.5**
2	**6,286**	**55.9**
3	**892**	**7.9**
4	**440**	**3.9**
5	**208**	**1.9**
6	**95**	**0.9**
Total	**11,241**	**100.0**

The following table shows the credit quality of the non-Rule 144A private placement portfolio at December 31, 2001.

	At December 31, 2001	
	Book Value	% of Total
	(In £ Millions, Except Percentages)	
NAIC Designation		
1	**1,035**	**33.8**
2	**1,141**	**37.3**
3	**282**	**9.2**
4	**519**	**17.0**
5	**35**	**1.2**
6	**47**	**1.5**
Total	**3,059**	**100.0**

Residential Mortgage-Backed Securities

At December 31, 2001, Jackson National Life had £5,450 million of residential mortgage-backed securities, including commercial mortgage obligations, representing 20.4% of US insurance total investments. Although this percentage is high compared to the average US insurance company, Jackson National Life believes these securities provide additional yield and liquidity. At December 31, 2001, 70.7% of Jackson National Life's residential mortgage-backed securities were rated AAA or the equivalent by a nationally recognized statistical ratings organization, and 97.0% were rated NAIC 1.

The primary investment risk associated with residential mortgage-backed securities is that a change in the interest rate environment could cause payment of the underlying obligations to be made more slowly or quickly than was anticipated at the time of their purchase. If interest rates decline, then this risk is called "pre-payment risk" and the underlying obligations will generally be repaid more quickly when the yields on reinvestment alternatives are lower. Alternatively, if interest rates rise, the risk is called "extension risk" and the underlying obligations will generally be repaid more slowly when reinvestment alternatives are higher. Residential mortgage-backed securities offer additional yield to compensate for these risks. Jackson National Life manages pre-payment risk, in part, by reducing crediting rates on its products.

Commercial Mortgage-Backed Securities

At December 31, 2001, Jackson National Life had £1,001 million, representing 3.8% of US insurance total investments invested in commercial mortgage-backed securities. 77.7% of this total was rated by Standard & Poor's or Moody's Investors Services and 77.0% was rated investment grade. Due to the structures of the underlying commercial mortgages, these securities do not present the same pre-payment or extension risk as residential mortgage-backed securities.

Other Fixed Income Securities

At December 31, 2001, Jackson National Life had £1,092 million of other fixed income securities, representing 4.1% of US insurance total investments.

Loans and Other

Loans and other totaled £4,614 million, representing 17.3% of US insurance total investments at December 31, 2001. Of the £4,614 million, £2,665 million consisted of loans and £1,949 million consisted of other financial investments.

Loans

Loans represented 10.0% of US insurance total investments at December 31, 2001. £2,184 million related to commercial mortgage loans and £481 million to policy loans.

Commercial Mortgage Loans

Commercial mortgage loans represented 8.2% of US insurance total investments at December 31, 2001. This total included 411 first mortgage loans with an average loan balance of approximately £5 million, collateralized by properties located in Canada and the United States. The vast majority of Jackson National Life's investments have been directly originated in the last six years.

Jackson National Life has addressed the risk of these investments by building a portfolio that is diverse both in geographic distribution and property type, emphasizing four main institutional property types: multi-family residential, retail, suburban office and warehouse/distribution facilities. These investments are often structured to minimize pre-payment risk through make-whole or lock-out pre-payment provisions.

As of December 31, 2001, approximately 22.8% of the portfolio was industrial, 22.7% multi-family residential, 24.2% retail, 20.1% suburban office and 8.7% hotel. Approximately 17.4% of the portfolio is secured by properties in Texas, 8.1% of the portfolio is secured by properties in California and 6.1% of the portfolio is secured by properties in Pennsylvania, with no other state representing more than 6% of the total origination.

Commercial mortgages generally involve more credit risk than residential mortgages due to several factors, including larger loan size, general and local economic conditions, local real estate conditions and the credit quality of the underlying tenants for the properties. Jackson National Life's investment policy and strict underwriting standards are designed to reduce these risks while maintaining attractive yields. In contrast to residential mortgage loans, commercial mortgage loans have minimal or no pre-payment and extension risk.

Policy Loans

Policy loans represented 1.8% of US insurance total investments at December 31, 2001. Policy loans are fully secured by individual life insurance policies or annuity policies and are contractual arrangements made under the policy.

Other

Other financial investments, representing 7.3% of US insurance total investments at December 31, 2001, were made up of £1,288 million of cash and short-term investments, £529 million of investments in limited partnerships and £132 million of other miscellaneous investments.

The largest investment in the limited partnerships category is a £142 million interest in the PPM America Private Equity Fund. The remainder of this category consists of diversified investments in 135 other partnerships managed by independent money managers that invest in various equity and fixed income loans and securities.

Equity Securities

Equity securities supporting US insurance operations totaled £186 million at December 31, 2001 and consisted of £110 million of common stocks and £76 million of preferred stocks.

Common Stock

The £110 million of investments in common stocks included £62 million of investments in mutual funds and £48 million of other investments in common stocks at December 31, 2001.

Preferred Stock

The £76 million of investments in preferred stocks included £56 million of private equity preferred stocks at December 31, 2001.

Real Estate

At December 31, 2001, Jackson National Life had £64 million of investments in real estate, £42 million of which is real estate Jackson National Life occupies and uses.

Investments Relating to Asian Insurance Business

Prudential's Asian operations' investments, other than investments in respect of unit-linked business, largely support the business of its Singapore, Hong Kong, Malaysia, Japan and Taiwan operations. The products Prudential offers in Asia are designed to enable it to invest a substantial proportion of the with-profits funds in equities, although local regulatory restrictions in some Asian countries limit the amount that may be invested in equities. Prudential's equity investments in Asia are spread across the principal Southeast Asian equity markets.

The following table shows Prudential Asia's investments, other than investments from unit-linked business at December 31, 2001. In this table, investments are valued on the same basis as in the consolidated financial statements.

	At December 31, 2001	
	Market Value	% of Total
	(In £ Millions, Except Percentages)	
Debt and other fixed income securities	2,432	58.8
Equity securities	825	20.0
Loans and other	722	17.5
Real estate	125	3.0
Participating interests	28	0.7
Total	4,132	100.0

	At December 31, 2001	

With the exception of a deliberate policy to hold short-term assets in Indonesia, Prudential manages interest rate risk in Asia by matching liabilities with fixed interest assets of the same duration to the extent possible. Asian fixed interest markets however, have a relatively short bond issue term, which makes complete matching impossible. A large proportion of the Hong Kong liabilities is denominated in US dollars and Prudential holds US fixed interest securities to back these liabilities.

Investments Relating to Banking Business

At December 31, 2001, Prudential had total banking investments of £8,753 million. The following table summarizes the investment portfolios relating to the UK and US banking businesses. In this table, investments are valued on the same basis as in the consolidated financial statements.

	At December 31, 2001			
	UK	**US**	**Total**	**Total %**
	(In £ Millions, Except Percentages)			
Other financial investments				
Debt and other fixed income securities	**3,061**	**192**	**3,253**	**37.2**
Loans and other	**4,779**	**696**	**5,475**	**62.6**
Equity securities		**13**	**13**	**0.1**
Total other financial investments	**7,840**	**901**	**8,741**	**99.9**
Real estate	**9**	**3**	**12**	**0.1**
Total	**7,849**	**904**	**8,753**	**100.0**

Of the £3,061 million debt and other fixed income securities relating to the UK banking business, £132 million was in respect of certificates of deposit maturing in less than three months.

The following table shows UK banking business loans by type and repayment period at December 31, 2001.

	At December 31, 2001				
	Due in One Year or Less	**Due in Over One Year and Up to Five Years**	**Due in Over Five Years**	**Provision for bad and doubtful debts**	**Total**
	(In £ Millions)				
Unsecured personal loans	**14**	**575**	**8**	**(35)**	**562**
Credit card receivables	**1,769**			**(43)**	**1,726**
Residential mortgages	**2**	**55**	**2,370**	**(3)**	**2,424**
Loans to banks	**67**				**67**
Total	**1,852**	**630**	**2,378**	**(81)**	**4,779**

The following table shows UK banking business loans by type and interest rate at December 31, 2001.

	At December 31, 2001			
	Fixed Rate	Variable Rate	Provision for bad and doubtful debts	Total
	(In £ Millions)			
Unsecured personal loans	597		(35)	562
Credit card receivables		1,769	(43)	1,726
Residential mortgages	270	2,157	(3)	2,424
Loans to banks	60	7		67
Total	927	3,933	(81)	4,779

Information Regarding Merger with American General Corporation

On March 12, 2001, Prudential announced an all-share merger with American General Corporation, a Texas corporation. The terms of the merger agreement provided for a share exchange ratio of 3.6622 Prudential shares (or 1.8311 Prudential American depository shares) for each American General share. On May 11, 2001, the merger agreement between Prudential and American General was terminated. In accordance with the merger agreement, American General paid Prudential the full termination fee of £423 million (US$600 million) required under the contract.

Description of Property

The Prudential group occupies 50 properties in the United Kingdom. These properties are primarily offices with some ancillary storage/warehouse facilities. Its headquarters located in London, together with other offices in London, Reading, Chelmsford, Dudley and Derby in England and Stirling in Scotland, are the most significant of these properties. It holds the Stirling property, a property in Chelmsford and a property in Derby on a freehold basis and the remaining properties as long-term leaseholds. Apart from three freehold offices, the balance of the 50 properties represents a mix of leasehold office space ranging in size from 3,000 to 146,000 square feet. Overall, the occupied property portfolio totals approximately 1,600,000 square feet. In addition to these properties, the Prudential group owns the freehold of a sports facility in Reading.

The Prudential group also holds leaseholds on approximately 182 other properties in the United Kingdom. This surplus accommodation consists primarily of small offices spread geographically across the United Kingdom and totals approximately 550,000 square feet of leasehold property. Prudential has begun a two year program aimed at reducing its property portfolio, and its associated costs, in line with the restructuring of its UK business. The estimated cost of the program is £12 million, to be financed using internal funds.

Within France, Germany and Ireland, Prudential currently leases approximately 85,000 square feet of office space.

In the United States, Prudential owns Jackson National Life's executive and principal administrative offices. These offices are located in Michigan. Prudential also leases premises in Michigan, Colorado, California, New Jersey and Georgia for certain of its operations. Prudential leases regional marketing sales offices in eight locations, and holds 15 operating leases with respect to office space, throughout the United States. In the United States, Prudential owns and leases a total of approximately 485,000 square feet of property. In addition, Prudential is planning to lease or purchase approximately 24,000 square feet of property in 2002 in Colorado and Michigan as an expansion of existing facilities and a disaster recovery site.

Prudential owns or leases properties elsewhere, principally in Hong Kong, Singapore, Malaysia, Indonesia, Thailand, The Philippines, China, Taiwan, Japan, Vietnam, India and Korea. Within these countries, Prudential holds 37 offices on a freehold basis, six offices on a leasehold basis and 266 operating leases in respect of office space, totaling approximately 2,700,000 square feet of property. In addition, Prudential holds 12 freeholds in Taiwan and two operating leases in Vietnam relating to storage/warehousing facilities, totaling approximately 25,000 square feet of property. Prudential is looking to acquire additional square footage in Asia of approximately 185,000 square feet.

Prudential believes that its facilities are adequate for its present needs in all material respects.

Prudential had tangible assets, principally computer equipment, furniture and fixtures of £241 million, £288 million and £239 million at December 31, 2001, 2000 and 1999 respectively.

Competition

General

There are significant participants in each of the financial service markets in which Prudential operates. Its competitors include both mutual and stock financial companies. In addition, regulatory and other developments in many of Prudential's markets have obscured traditional financial service industry lines and opened the market to new competitors and increased competition. Some new entrants are taking advantage of the low barriers to entry afforded by internet distribution, especially in the area of retail banking. In some of Prudential's markets, other companies may have greater financial resources, allowing them to benefit from economies of scale, and may have stronger brands than Prudential does in that market.

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

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

An important competitive factor is the ratings Prudential receives in some of its target markets, most notably in the United States, from recognized rating organizations. The intermediaries with whom Prudential works, including IFAs, agents, brokers, wholesalers and financial institutions consider ratings as one factor in determining from which provider to purchase financial products. Prudential Assurance's long-term fund is currently rated AAA and Jackson National Life is rated AAA by Standard & Poor's. Jackson National Life is currently rated AA+ by Fitch Ratings, A+ by A.M. Best Co and Aa3 by Moody's Investors Service Inc. Any change in Prudential's current ratings could affect the sale of its products and the persistency of its in-force business. A downgrade in ratings could adversely affect Prudential sales in the same markets.

Prudential offers different products in its different markets of the United Kingdom, the United States and Asia and, accordingly, faces different competitors and different types of competition in these markets.

The United Kingdom

Prudential's principal competitors include all the major stock and mutual retail financial services and fund management companies operating in the United Kingdom. These companies include CGNU, Legal & General, Standard Life, Friends Provident, Britannic, Lloyds TSB, Halifax, Abbey National, Aegon, AXA, Zurich Financial Services, Fidelity, Invesco, Threadneedle and Schroder. Prudential competes with other providers of financial products to be included on the preferred panels of IFAs.

In the United Kingdom, the level of bonuses on Prudential's with-profits products is an important competitive measure for attracting new business through IFAs. The ability to declare competitive bonuses depends, in part, on a company's financial strength, which enables it to adopt an investment approach with a higher weighting in equities and real estate and allows it to smooth the fluctuations in investment performance upon which bonuses are based. Bonus rates on Prudential's with-profits policies are in line with those of its major competitors.

The United States

Jackson National Life's competitors in the United States include major stock and mutual insurance companies, mutual fund organizations, banks and other financial services companies. National banks, in particular, may become more significant competitors in the future for insurers who sell annuities, as a result of recent legislation, court decisions and regulatory actions. Jackson National Life's principal life insurance company competitors in the United States include AXA, Lincoln National Corporation, Transamerica Corporation, Nationwide Financial Services, Inc., Sunamerica, Inc. and Hartford Life, Inc.

Jackson National Life does not have a career agency salesforce in the United States and, consequently competes for distributors such as banks, broker-dealers and wholesalers. Jackson National Life also competes with other providers of financial products to be placed at the top of the independent agents' list of sources.

Asia

Competition in the Asian markets in which Prudential operates is currently focused on distribution, with particular emphasis on the size and composition of the agency salesforce. Within the Asian region, its principal competitors are non-Asian financial companies, including AIG, Allianz, AXA, ING/Aetna, and Manulife. Prudential also faces competition within each country from local and Asian financial companies, including Great Eastern Life in Singapore and Malaysia, Malaysia Assurance Alliance in Malaysia and CathayLife in Taiwan.

Intellectual Property

Prudential does not operate in the United States under the Prudential name and there have been long-standing arrangements between it and Prudential Insurance Company of America relating to their respective uses of the Prudential name. Prudential and Prudential Insurance Company of America have now made competing trademark claims in various jurisdictions around the world and legal proceedings in connection with these matters have commenced.

Legal Proceedings

Prudential Assurance

Surplus Assets in Prudential Assurance's Long-Term Fund

Prudential's surplus assets, or inherited estate, are the assets of the main with-profits fund within the long-term fund of Prudential Assurance less non-participating liabilities, the policyholder asset shares aggregated across with-profits policies and any additional amounts expected at the valuation date to be paid to in-force policyholders in the future in respect of smoothing costs and guarantees. The inherited estate is thus the assets in the with-profits fund in excess of what Prudential expects to pay to policyholders. Prudential is currently discussing the attribution of its inherited estate with the FSA, which may or may not result in a portion of the inherited estate in the main with-profits fund being attributed solely to shareholders. The amount and timing of any attribution to shareholders is sufficiently uncertain that it is not possible to accurately estimate any potential attribution. In addition, it is likely that if any part of the inherited estate is attributed to shareholders, it will remain in Prudential Assurance's long-term fund to support the long-term business and accordingly is unlikely to be distributed to shareholders for some considerable period of time, if at all.

In December 2000, proceedings were commenced against The Prudential Assurance Company Limited (Prudential Assurance) by a policyholder. These proceedings relate to the inherited estate in Prudential Assurance's with-profits fund and they essentially ask the court to decide whether and, if so, to what extent the inherited estate should be attributed to, or applied for the benefit of, policyholders and/or shareholders. Prudential continues to consider the proceedings and the issues raised by them with its legal advisers.

Jackson National Life

Jackson National Life is involved in litigation arising in the ordinary course of business, including a number of civil proceedings substantially similar to other litigation brought against many life insurers alleging misconduct in the sale of insurance products. These matters are sometimes referred to as market conduct litigation. Several suits against Jackson National Life seek to certify various classes of policyholders who purchased Jackson National Life life insurance or annuity products during various periods from 1981 to present. Jackson National Life has retained experienced national and local counsel and is vigorously defending these actions. It is not feasible at this stage of the ongoing actions to meaningfully estimate the amount or range of loss, if any, that could result from any unfavorable outcome. Most of the suits, including one which was on appeal to the Supreme Court in the State of Mississippi, were settled in January 2002 for a sum of £7 million.

Prudential Group

Prudential and it subsidiaries are involved in other litigation arising in the normal course of business. Although the outcome of such matters cannot be predicted with certainty, management believes that the ultimate outcome of such litigation will not have a material adverse effect on the group's financial condition, results of operations or cash flows.

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 Association of British Insurers, the UK Department of Trade and Industry, Association of Unit Trusts and Investment Funds, A.M. Best, Moody's, Standard and Poor's, Cazenove, UBS Warburg, Life Insurance Marketing and Research Association, the Variable Annuity Research Data Service, referred to as VARDS, Townsend and Schupp, The Advantage Group, the Life Insurance Association of Singapore, the Hong Kong Federation of Insurers, Life Insurance Association of Malaysia, Life Insurance Association of Taiwan and the Taiwanese Securities Investment Trust Consulting Association.

SUPERVISION AND REGULATION OF PRUDENTIAL

Prudential's principal insurance, investment and banking operations are in the United Kingdom, the United States and Asia. Accordingly, it is subject to applicable United Kingdom and United States insurance, banking and other financial services regulation which is discussed below, and the regulations of the twelve Asian countries in which it operates.

UK Supervision and Regulation

The Financial Services and Markets Act 2000

Coming into Force of the Financial Services and Markets Act 2000

On December 1, 2001 significant sections of the Financial Services and Markets Act 2000 (referred to below as the 2000 Act) came into force. The Financial Services Authority (referred to below as the FSA) became the statutory regulator for insurance, investment and banking business in the UK, subject to the overall control of HM Treasury. The Insurance Companies Act 1982, the Financial Services Act 1986 (referred to below as the 1986 Act) and the Banking Act 1987 have been repealed and the regulatory regimes operated under those Acts have been disapplied.

The self-regulating organizations, or SROs, which had previously been responsible under the 1986 Act for regulating investment business have transferred responsibility to the FSA. By virtue of the "grandfathering" rules implemented by the FSA, insurance companies and firms previously authorized by SROs to conduct particular investment business have automatically been permitted to conduct their business under the new regime, and are therefore regarded as authorized persons.

An overview of the regulatory regime brought about by the 2000 Act is set out below.

Risk-Based Regulation

A fundamental change introduced by the 2000 Act regime is a new risk-based regulatory approach to all financial business designed to integrate and simplify the different approaches formerly adopted by the UK Department of Trade and Industry and the FSA for insurance business, the Bank of England for banking business and the SROs for investment business.

Overview of 2000 Act Regulatory Regime

Single Regulator

The FSA is the single regulator for all authorized persons with respect to every regulated activity in the investment business sector. In this regard, the FSA is authorized to make rules and issue guidance and codes in relation to a wide sphere of activity encompassing the governance of the conduct of business by, and the prudential supervision of, authorized persons.

Permission to carry on "Regulated Activities"

Under the 2000 Act no person may carry on or purport to carry on a regulated activity in the United Kingdom unless he has received FSA permission to carry on one or more regulated activities and, as a result, is an authorized person.

"Regulated activities" are prescribed in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and comprise banking activities, insurance activities and the principal activities for which authorization used to be required under the 1986 Act. These include dealing in investments as principal or agent, together with certain notable additional activities, such as entering into and administering regulated mortgage contracts and the establishment, operation and winding up of a stakeholder pension scheme, as described below.

Single Authorization Procedure

The 2000 Act has introduced a single authorization procedure by which a firm becomes an authorized person by virtue of being granted permissions by the FSA to carry out specific regulated activities. The FSA may grant permission to carry out any regulated activity and may delineate the scope of, and include such restrictions to, its permission as it deems appropriate.

In granting or varying the terms of its permission the FSA must ensure that the firm meets certain threshold conditions, which among other things require it to have adequate resources for the carrying on of its business, and to be a fit and proper person, having regard to all the circumstances.

In addition to the threshold conditions to authorization, firms are obliged to comply with the FSA Principles for Business, which are high level principles for conducting financial services business in the UK.

In parallel, the 2000 Act includes the "approved persons" regime, whereby firms are obliged to secure the approval of the FSA to the appointment of individuals performing certain important functions within a firm or on its behalf with respect to the carrying on of regulated activities.

Market Abuse

Under the 2000 Act, the FSA is empowered to instigate proceedings in connection with offences concerning the financial markets. Most significantly, the 2000 Act introduces the concept of market abuse behavior occurring in relation to certain investments traded on a prescribed market which a reasonable person who regularly deals on such market in investments of the kind in question would regard as amounting to a failure to observe the standard of behavior reasonably to be expected of a person in such a position in relation to the market. Market abuse may be committed both by authorized and unauthorized persons. The FSA has the power to apply sanctions upon the occurrence of market abuse, but the person upon whom sanction is imposed may refer the matter for hearing by the Financial Services Tribunal, from which appeal lies to the Court of Appeal, provided either the Tribunal or the Court grants permission.

Application of 2000 Act Regulatory Regime to Prudential

By carrying on regulated activities, each of Prudential's principal UK insurance, investment and banking businesses is subject to regulation and supervision by the FSA. The following discussion considers in turn the main features of the 2000 Act regime applicable to Prudential's insurance, investment and banking businesses in the United Kingdom.

Regulation Applicable to Prudential's Insurance, Investment and Banking Businesses

In light of the unified approach to regulation introduced by the 2000 Act, the financial services regulation described below is applicable to Prudential's regulated businesses generally.

Supervision of Management and Change of Control

The FSA closely supervises the management of firms through the approved persons regime, by which any appointment of persons to a position of significant influence within an authorized person must be approved by the FSA.

The FSA must approve any proposed acquisition of 10% or more of the shares or voting rights in an authorized person or its parent and any increase in control over 20%, 33% and 50% of the shares or voting power of an authorized person or its parent.

FSA approval is also required in circumstances where a person, taken together with any associates, becomes able to exercise significant influence over an authorized person or its parent by virtue of his shareholding or voting power in either.

In considering whether to grant or withhold its approval, the FSA must be satisfied both that the acquirer is a fit and proper person to have control over the authorized person that he either has or would have if he acquired the control in question, and that the interests of consumers would not be threatened by the acquirer's control or by his acquiring control.

Intervention and Enforcement

The FSA has extensive powers to investigate and intervene in the affairs of an authorized person. The 2000 Act imposes on the FSA statutory obligations to monitor compliance with the requirements imposed by, and to enforce the provisions of, the 2000 Act, related secondary legislation and the rules made thereunder.

The FSA's enforcement powers, which may be exercised against both authorized and approved persons, include public censure, imposing unlimited fines and, in serious cases, the revocation or variation of permission to carry on regulated activities or of an approved person's approval. In addition, the FSA may revoke an authorized person's permission if it is necessary to protect the interests of consumers or potential consumers.

The FSA has further powers to obtain injunctions against authorized persons and to impose or seek restitution orders where persons have suffered loss. Once the FSA has made a decision to take enforcement action against an authorized or approved person (other than in the case of an application to the court for an injunction or restitution order), the person affected may refer the matter to the Financial Services Tribunal.

In addition to its ability to apply sanctions for market abuse (described above), the FSA has the power to prosecute criminal offences arising under the 2000 Act and insider dealing under Part V of the Criminal Justice Act 1993 and breaches of money laundering regulations. The FSA's stated policy is to pursue criminal prosecution in all appropriate cases.

Finally, the 2000 Act grants the FSA certain important powers with respect to insolvency proceedings and authorized persons. The FSA, although not a creditor, may seek administration orders under the Insolvency Act 1986 (as amended), present a petition for the winding-up of an authorized person or have standing to be heard in the voluntary winding-up of an authorized person (other than insurers carrying on long-term insurance business, which cannot voluntarily be wound up see " Winding-Up Rules" below).

FSA Conduct of Business Rules

The FSA Conduct of Business Rules apply to every authorized person carrying on regulated activities and regulate the day-to-day conduct of business standards to be observed by authorized persons in carrying on regulated activities. The Conduct of Business Rules in many ways reflect the standards of conduct prescribed under the 1986 Act regulatory regime, but there are a number of important developments relevant to Prudential's business.

Financial Promotion

The Conduct of Business Rules prescribe stringent rules relating to the circumstances and manner in which authorized persons may communicate and approve "financial promotions", which are communications in the course of business of invitations or inducements to engage in investment activity.

Polarization and Financial Promotion

The polarization rules required employed staff or tied agents to advise on and sell the packaged products of only one company or group. Independent financial advisers must advise on the whole range of packaged products offered by companies in the relevant sector. The FSA relaxed the polarization rules in March 2001 with respect to stakeholder pension schemes and direct offer financial promotions for packaged products (which include life policies other than pure protection policies, pensions, regulated collective investment schemes and investment trust savings schemes). As a result of these changes, tied salesforces and appointed representatives of product provider firms are now free to market stakeholder pensions manufactured by any other company, and authorized persons may directly offer the packaged products of other authorized persons to the public (although if advice is provided, the advising authorized person remains responsible for that advice, regardless of which company's product is recommended).

Further relaxation of the polarization rules is expected following the publication in January 2002 of FSA Consultation Paper 121, "Reforming Polarization: Making the Market Work for Consumers", in which the FSA makes a number of proposals for the reform of polarization (described in more detail below) which, if adopted, would fundamentally alter the relationship between product manufacturers and distributors.

The principal proposal made by the FSA in Consultation Paper 121 is that polarization *per se* be abolished. On abolition, existing independent financial advisers would have to decide whether to remain as "independent" advisers, or to become "distributors" that is, tied to a number of product manufacturers. Existing tied agents would have to decide whether to continue with a tie to a single manufacturer, or to become multi-tied "distributors".

The FSA additionally proposes the prohibition of commission charging by independent advisers so that payments made by customers to independent financial advisers no longer depend on product purchases: as a result, the independent adviser's remuneration would be based on a fixed fee, retainer or hourly rate charge. Any commission which may be received by the independent adviser must either be rebated to customers or applied against incurred fees.

The FSA also proposes to remove the current restrictions on the ability of product manufacturers to hold significant interests in independent financial advisers. If the proposal is adopted, independent advisers would be required to disclose to customers the extent of ownership by product manufacturers so as to prevent the use of equity ownership *de facto* to tie independent advisers.

The Financial Services Ombudsman Scheme

The 2000 Act replaces the various customer complaint resolution schemes operated for insurance, investment and banking business prior to December 1, 2001 with the introduction of a unified ombudsman scheme applicable to complaints arising from the carrying on of all regulated activities. The Financial Services Ombudsman Scheme is intended to provide speedy, informal and cost effective dispute resolution of a firm's individual and small-business customers' complaints, and the Ombudsman is empowered to order firms to pay fair compensation for loss and damage, and may order a firm to take such steps as it determines to be just and appropriate to remedy a complaint.

The Financial Services Compensation Scheme

The 2000 Act provides for the establishment of a compensation scheme intended to compensate individuals and small businesses for loss occasioned in respect of business carried on by an authorized person in violation of the rules of the 2000 Act regulatory regime in circumstances where such an authorized person is unable or unlikely to be able to satisfy claims against him.

The Scheme is divided into three sub-schemes reflecting the different kinds of business undertaken by authorized persons: banking, insurance and investment business.

The scheme is funded by contributions referable to the particular sub-schemes so as to minimize cross-subsidy between authorized persons whose businesses are not similar.

The Financial Services Compensation Scheme replaces the various compensation schemes for insurance, investment and banking business operated prior to December 1, 2001.

Regulation of Insurance Business

Effecting and carrying out a contract of insurance as principal are each regulated activities in respect of which FSA permission is required under the 2000 Act, and the carrying on of such regulated activities is referred to as insurance business.

Some of Prudential's subsidiaries, including The Prudential Assurance Company Limited, Scottish Amicable Life plc, Prudential Annuities Limited, Prudential Retirement Income Limited and Prudential Pensions Limited, carry on insurance business in the United Kingdom with the permission of the FSA and are supervised by the FSA under the 2000 Act.

The FSA regulates insurance business principally through the issuance of rules with which authorized persons are required to comply, and in particular, the FSA Interim Prudential Sourcebook for Insurers (referred to below as the Insurer's Sourcebook) prescribes rules and guidance specifically for authorized persons carrying on insurance business.

Under the Insurer's Sourcebook, an insurance company is restricted from carrying on any activities other than in connection with or for the purposes of its insurance business.

Long-term Assets and Liabilities

Long-term business assets and liabilities those assets and liabilities relating to, broadly, life and health insurance policies must be segregated from the assets and liabilities attributable to non-life insurance business or to shareholders. Separate accounting and other records must be maintained and a separate fund must be established to hold all receipts of long-term business.

The extent to which long-term fund assets may be used for purposes other than long-term business is restricted by the Insurer's Sourcebook. Only the "established surplus" the excess of assets over liabilities in the long-term fund, as determined by an investigation by the appointed actuary may be transferred so as to be available for other purposes. Restrictions also apply to the payment of dividends by the insurance company or its parent, as described below. In practice, the level of assets held in the long-term fund will need to remain well in excess of the insurer's long-term liabilities.

Solvency Requirements

The Insurer's Sourcebook also requires that insurance companies maintain a margin of solvency at all times in respect of both any long-term insurance and general insurance undertaken by the insurance company, the calculation of which in any particular case depends on the type and amount of insurance business a company writes. The method of calculation of the solvency margin is set out in the Insurer's Sourcebook, and for these purposes, an insurer's assets and its liabilities are subject to specific valuation rules set out in the Insurer's Sourcebook. Failure to maintain the required solvency margin is one of the grounds on which wide powers of intervention conferred upon FSA may be exercised.

Appointed Actuary

Under the Insurer's Sourcebook, every insurance company that carries on long-term business must appoint an actuary. The appointed actuary must prepare an annual report for the company's directors quantifying the company's long-term liabilities attributable to the insurance company's long-term insurance business, determining the value of any excess over those liabilities of the assets representing the long-term insurance fund and where any rights of long-term policyholders to participate in profits relate to particular parts of such a fund, a valuation of any excess of assets over liabilities in respect of each of those parts.

The appointed actuary must be an "approved person" and must comply with the regulatory provisions applicable to approved persons. Furthermore, the appointed actuary has a professional duty to be satisfied at all times as to the solvency of the company and that policyholders' reasonable expectations are safeguarded. The UK Institute of Actuaries and the UK Faculty of Actuaries require all members, including appointed actuaries, to comply with their Professional Conduct Standards.

As part of its review of with-profits business, the FSA is addressing the role of the appointed actuary. Through an industry consultation process, the FSA is currently considering whether the requirement that an insurance company have an appointed actuary should be retained in light of the responsibilities already imposed upon the board of an insurance company under the 2000 Act regime, and, if the requirement to have an appointed actuary is to be retained, whether the current regulatory regime could be improved, for example, by minimizing potential conflicts of interest and by providing mechanisms to ensure the independence and reliability of the appointed actuary's work.

Distribution of Profits

An insurance company carrying on long-term business, and any parent of such a company, cannot declare a dividend when the liabilities of the long-term business exceed the assets of the long-term fund, in each case as determined in accordance with the valuation rules prescribed by the Insurer's Sourcebook. The Insurer's Sourcebook also provides that, once an allocation of surplus in a with-profits fund has been made to policyholders, no transfer of assets representing any part of a subsequent surplus can be made, to shareholders or otherwise, unless either the "relevant minimum" (as defined in the Insurer's Sourcebook) of the surplus has been allocated to policyholders or a statutory notification procedure has been followed. Calculation of the relevant minimum is based upon the percentage of the relevant surplus previously allocated to eligible policyholders.

Under the Insurer's Sourcebook, the parent of an insurance company is not prohibited from declaring dividends in circumstances where the value of the long-term insurance business assets is less than the amount of the long-term insurance business liabilities. HM Treasury however is given power under the 2000 Act to make regulations preventing an insurance company's parent from doing anything to lessen the effectiveness of any "asset identification rules" made by the FSA, which will include in this context rules requiring insurers to maintain the solvency of the long-term fund.

There has been considerable public debate regarding the rights and legitimate expectations of with-profits policyholders to assets forming part of an insurance company's surplus, particularly where such assets do not derive from the payment of current policyholders premiums but are rather "inherited" from previous generations of policyholders or from other entities.

There are currently two separate reviews being carried out with respect to with-profits business. The FSA is conducting a review of with-profits business and is expected to publish a report of its findings by the second half of 2002. Concurrently with the FSA review, HM Treasury has commissioned a review of the medium and long-term retail savings industry, which is scheduled to conclude in the second half of 2002. This review specifically addresses with-profits business, and the perceived opacity of the policies and the high level of discretion exercised by product providers.

While it is difficult to predict the impact of each of the FSA's review of with-profits business and HM Treasury's review of the retail savings industry since they are not yet complete, their potential impact on with-profits business may be dramatic and, in the most extreme case, may lead to a radical transformation of the manner in which with-profits business is conducted.

Reporting Requirements

Under the Insurer's Sourcebook, insurance companies must file with the FSA their audited accounts and appointed actuaries' reports.

Equalization Reserves

The Insurer's Sourcebook requires every insurance company to maintain certain equalization reserves in respect of both general and credit insurance business, and to comply with the equalization reserve rules of the Insurer's Sourcebook.

Transfer of Insurance Business

Before any transfer of insurance business may take place, the 2000 Act requires a scheme of transfer to be prepared and approved by the High Court.

Winding-Up Rules

The general insolvency laws applicable to UK companies are modified in certain respects in relation to insurance companies. In particular, insurance companies are not subject to the administration procedures in the UK Insolvency Act 1986 (as amended) and holders of long-term policies are permitted to claim not only what is owing to them but also in respect of their reasonable expectations. Furthermore, instead of making a winding-up order when an insurance company has proved unable to pay its debts, a UK court may under section 378 of the 2000 Act reduce the amount of the insurance company's contracts on terms and subject to conditions which the court considers just. Where an insurance company is in financial difficulties but not in liquidation, the Financial Services Compensation Scheme has certain powers, including the power to take measures for securing the transfer of all or part of the business to another insurance company.

Section 376 of the 2000 Act provides further insolvency protection to insurance companies effecting or carrying out contracts of long-term insurance. Without the permission of the court, a liquidator must carry on the insurer's business so far as it consists of carrying out the insurer's contracts of long-term insurance with a view to it being transferred as a going concern. In carrying on the business, the liquidator may agree to the variation of any contracts of insurance in existence when the winding-up order is made, but must not effect any new contracts of insurance.

European Union Directive on Group Supervision

The European Union formally adopted directive 98/78/EC on the supplementary supervision of insurance undertakings within a group, referred to below as the "Insurance Groups Directive" in October 1998. Currently, under European law, insurance regulation, including in respect of solvency, is directed at individual insurance companies, (so-called "solo supervision") and makes no specific provision for particular issues which arise in the context of a member of a group. The directive does not change this basic approach, but requires member states to introduce the following measures to strengthen supervision of insurance companies which are part of a group:

an adjustment to the solo supervision solvency calculation in relation to participating interests in other insurance undertakings in order to eliminate "double-gearing" (the use of the same capital to cover different risks within a group);

an additional parent undertaking solvency margin calculation analogous to the adjusted solo solvency margin test referred to above, to be applied at the level of the parent undertaking;

the introduction of new solo-supervision requirements, including rules as to internal control within the insurance undertaking regarding the production of information relevant to supplementary supervision, the exchange of information within the group and the supervision of intra-group transactions; and

further provisions aimed at ensuring co-operation between competent regulatory authorities of member states.

The directive's requirements are to be adopted for financial years beginning on or after January 1, 2001. The United Kingdom has implemented the requirements of the directive which are new to the United Kingdom through the Insurer's Sourcebook.

The changes to solo supervision calculations will be reflected in the regulatory returns to the FSA for the year ended December 31, 2001 for Prudential Assurance Company and Prudential's other UK insurance subsidiaries. The parent undertaking solvency margin under the legislation that implements the Directive is filed privately with the FSA and differs from the adjusted solo solvency margin test in that it is a calculation rather than a formal test. The Insurance Groups Directive requires that the calculation be performed and that if, on the basis of the calculation, the competent regulatory authorities conclude that the solvency of the regulated direct insurers are, or may be jeopardized, they take appropriate measures at the level of those insurers. It is anticipated that the implementation of these requirements should not impact on the Prudential Group's activities, capital structure, or other commercial arrangements.

Regulation of Investment Business

Certain of Prudential's subsidiaries are authorized by the FSA to carry on investment business. These entities are subject to regulation and supervision by the FSA and must comply with the FSA Conduct of Business Rules and all other applicable rules prescribed by the 2000 Act regime.

Certain forms of investment business introduced by the 2000 Act are either novel, or were not regulated under the regime of the 1986 Act. The establishment, operation and winding-up of a stakeholder pension scheme is a regulated activity, and rights under a stakeholder pension scheme are defined as "investments" for the purposes of the 2000 Act regime, so that dealing, arranging, managing, advising and providing custody activities in respect of rights relating to a stakeholder pension also constitute regulated activities.

Entering into and administering mortgage contracts relating to land used as a dwelling by the borrower or his relatives are each a regulated activity under the 2000 Act regime, so that, following the expiry of the transitional provisions referred to below, appropriate permission from the FSA must be obtained before such regulated activities may be carried on. In addition, HM Treasury has recently announced that the provision of mortgage advice will also become a regulated activity once the FSA has completed its consultation process.

HM Treasury has introduced transitional provisions with respect to mortgage contracts whereby the regulated activities described above may be carried on for the time being without FSA permission.

The designation of effecting, administering and advising on mortgages as regulated activities constitutes a significant extension of the 1986 Act regime under which there were no comparable forms of investment business. In light of the fact that grandfathering will not however be an appropriate means of obtaining permission for these activities, lenders will have to obtain FSA permission and devise new compliance procedures.

Regulation of Banking Business

The FSA has sole responsibility for banking supervision and regulation in the United Kingdom and has wide discretionary powers in relation to those banks it regulates. The FSA has wide investigatory and enforcement powers, including the power to require information and documents from banks, appoint investigators, apply to the court for injunctions in cases of breaches or likely breaches of rules, impose financial penalties, issue a public statement or censure and vary, cancel or withdraw authorization to carry on banking business.

Supervision

In its role as supervisor of banks, the primary objective of the FSA is to fulfill its responsibilities under the 2000 Act regime relating to the safety and soundness of banks with the aim of strengthening, but not guaranteeing, the protection of depositors. The FSA has adopted a risk-based approach to bank supervision.

The FSA requires Prudential to maintain a certain minimum capital adequacy ratio of total capital to risk-weighted assets and to report large exposures. The Interim Prudential Sourcebook for Banks, on a general level, requires banks operating in the United Kingdom to maintain adequate liquidity, taking into account the nature and scale of their business so that they are able to conduct business in a prudent manner and meet their obligations as they fall due. As part of its supervision, the FSA requires the banks subject to its supervision to provide the FSA with information that the FSA may reasonably require to perform its functions under the 2000 Act regime.

Transfer of Banking Business

Before any transfer of business wholly or partly involving deposit taking may take place, the 2000 Act requires a scheme of transfer to be prepared and approved by the High Court.

Solvency Requirements

The requirement to have adequate capital is one of the criteria for permission to accept deposits under the 2000 Act. A bank should have sufficient capital to provide a stable resource to absorb any losses arising from the risks in its business. In assessing a bank's capital adequacy, the FSA takes into account not only the level of a bank's own funds but also other matters such as concentration of the loan book (large exposures) and liquidity.

The FSA applies capital adequacy guidelines that accord with relevant EC directives and the Basel Accord of 1988, which established a framework for measuring the capital adequacy of international banking organizations. These guidelines implement a number of EC directives, including the Own Funds Directive, concerning capital requirements, the Solvency Ratio Directive, concerning solvency ratios that credit institutions must maintain, and the Capital Adequacy Directive, as amended, referred to as CAD, requiring credit institutions to provide capital for market risk. The FSA's guidelines impose on banks a requirement that they maintain a minimum level of capital to support on and off-balance sheet exposures, weighted according to broad categories of risk. Each bank subject to the FSA's guidelines must maintain a capital adequacy ratio of total capital to risk-weighted assets, of no less than 8%.

The FSA introduced a new market risk regime as from October 1, 1998 for implementation of its policy based on the Basel Accord and the parallel EC Market Risk Directive, known as the "CAD Amending Directive". Both the 1996 Basel Amendment to the Basel Accord and the CAD Amending Directive enable banks to use internal value-at-risk models to calculate capital charges for market risks.

Banks that have a trading book over a certain size are obliged to meet the trading book capital requirements of the CAD and the CAD Amending Directive in respect of the market-related and credit-related risks arising from their trading activities. This involves splitting their business between trading and banking books. UK banks are required to maintain, in interest-free accounts at the Bank of England, a cash balance, known as the cash ratio deposit, which is based on eligible liabilities, primarily pound sterling deposits less amounts on loan to other monetary institutions. Although these balances count towards the liquidity requirements for the real time gross settlement system introduced in the United Kingdom during 1996, they are generally regarded as non-operational and, accordingly, do not count towards overall liquidity requirements. The liquidity standard for sterling, which the UK government introduced in January 1996, requires the maintenance of sufficient holdings of liquid assets to cover potential cash outflows over the next five business days. This policy applies to UK-incorporated retail banks and group UK-based sterling operations.

In June 1999, the Basel Committee on Banking Supervision issued a proposal for a new capital adequacy framework to replace the Basel Accord of 1988. The new capital framework consists of three "pillars": minimum capital requirements that will expand and develop the standardized rules set out in the 1988 Accord, a supervisory review of an institution's capital adequacy and internal assessment process and effective use of market discipline to strengthen disclosure and encourage safe banking practices. In furtherance of its objective to replace the Basel Accord of 1988, on January 16, 2001 the Basel Committee published its consultation paper entitled "The New Basel Capital Accord" and is currently conducting an extended consultation process in connection with the paper with banking industry participants and intends to finalize the terms of a new capital adequacy accord during 2002. The Basel Committee hopes to implement the new accord in 2005.

On November 23, 1999, the European Commission published a consultation document on its proposals to review the existing capital adequacy framework for EU credit institutions and investment firms. The Commission's paper complements the Basel Committee's paper and similarly contains proposals on minimum capital requirements, supervisory review, and disclosure as an aid to market discipline.

The European Commission also launched on February 5, 2001 a second round of consultations on a new capital adequacy framework for banks and investment firms. New proposals will be drafted in light of the response to the second consultation, but their broad aim will be to:

reflect market change by taking into account the different needs of global players and locally acting institutions, with the one-size fits all approach likely to be abandoned;

align capital charges and underlying economic risk more closely;

provide incentives for enhanced risk mitigation standards; and

provide a framework to support a comprehensive assessment of the risks to which firms are exposed.

US Supervision and Regulation

General

Prudential conducts its US insurance activities through Jackson National Life, which is a stock life insurance company licensed to transact its insurance business in, and subject to regulation and supervision by, the District of Columbia and 49 of the 50 states; Jackson National operates a subsidiary, Jackson National Life Insurance Company of New York, in the state of New York. The extent of such regulation varies, but most jurisdictions have laws and regulations governing the financial aspects of insurance companies, including standards of solvency, reserves, reinsurance and capital adequacy and the business conduct of insurance companies. In addition, statutes and regulations usually require the licensing of insurers and their agents and the approval of policy forms and related materials. These statutes and regulations in Jackson National Life's state of domicile, which is Michigan, also set out the permitted types and concentration of investments.

Insurance regulatory authorities in each of the jurisdictions in which Jackson National Life does business require it to file detailed quarterly and annual financial statements, and these authorities have the right periodically to examine its operations and accounts. In addition, Jackson National Life is generally subject to federal and state laws and regulations that affect the conduct of its business. New York and Michigan require their state insurance authorities to conduct an examination of an insurer under their jurisdiction at least once every five years. The New York Insurance authorities conducted an examination of Jackson National Life of New York in 2000 and the report included no material findings. Michigan insurance authorities completed a routine examination of Jackson National Life during the year 2001. While the report is not yet final, preliminary information indicates that there were no material findings.

Jackson National Life's ability to pay shareholder dividends is limited under Michigan insurance law. The commissioner may limit, or not permit the payment of, shareholder dividends if the commissioner determines that an insurer's surplus, as regards policyholders, is not reasonable in relation to its outstanding liabilities and is not adequate to meet its financial needs as required by Michigan insurance law. Jackson National Life must report any shareholder dividends to the Michigan insurance commissioner before they can be paid. In the case of an extraordinary shareholder dividend or distribution, an insurer must give 30 days' advance notice to the commissioner and may not pay the dividend or distribution if the commissioner disapproves within such 30-day period. For this purpose, an extraordinary dividend or distribution means any dividend or distribution of cash or other property whose fair market value together with that of other dividends or distributions that an insurer made within the preceding twelve months exceeds the greater of 10% of the insurer's surplus as regards policyholders as of December 31 of the immediately preceding year, or the net gain from operations of the insurer, not including realized capital gains, for the prior year. In 1999, 2000 and 2001 Jackson National Life paid shareholder dividends of $96.3 million, $176.3 million and $131.1 million, respectively.

State regulators also require prior notice or regulatory approval of changes in control of an insurer or its holding company and of certain material transactions with affiliates. Under New York and Michigan insurance laws and regulations, no person, corporation or other entity may acquire control of an insurance company or a controlling interest in any parent company of an insurance company, unless that person, corporation or entity has obtained the prior approval of the regulator for the acquisition. For the purpose of New York and Michigan law, any person acquiring, directly or indirectly, 10% or more of the voting securities of an insurance company is presumed to have acquired "control" of the company. To obtain approval of any change in control, the proposed acquiror must file an application with the New York superintendent of insurance or the Michigan insurance commissioner, as appropriate. This application requires the proposed acquiror to disclose, among other information, its background, financial condition, the financial condition of its affiliates, the source and amount of funds by which it will effect the acquisition, the criteria used in determining the nature and amount of consideration to be paid for the acquisition, proposed changes in the management and operations of the insurance company and other related matters.

Guaranty Associations and Similar Arrangements

Each of the 50 states of the United States, the District of Columbia and Puerto Rico have laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. These associations and arrangements provide certain levels of protection to policyholders from losses under insurance policies that impaired or insolvent insurance companies issue. Typically, these associations levy assessments, up to prescribed limits, on member insurers on a basis that is related to the member insurer's proportionate share of the business in the relevant jurisdiction of all member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Some jurisdictions permit member insurers to recover assessments that they paid through full or partial premium tax offsets, usually over a period of years.

Asset Valuation Reserve

State regulators generally require that insurers establish an asset valuation reserve that consists of two components: a default component to provide for future credit-related losses on fixed income investments and an equity component to provide for losses on all types of equity investments. The asset valuation reserve establishes statutory reserves for fixed maturity securities, equity securities, mortgage loans, equity real estate and other invested assets. The reserve is designed to capture all realized and unrealized gains and losses on such assets, other than those resulting from changes in interest rates. The level of reserves is based on both the type of investment and its rating. Contributions to the reserve may result in a slower growth in surplus or a reduction of Jackson National Life's unassigned surplus, which, in turn, reduces funds available for shareholder dividends or shareholder distributions. The extent of the impact of its asset valuation reserve on Jackson National Life's surplus depends in part on the future composition of the investment portfolio.

Interest Maintenance Reserve

State regulators generally require that insurers establish an interest maintenance reserve to defer non-credit-related realized capital gains and losses, net of taxes, on fixed income investments, primarily bonds and mortgage loans, which are amortized into net income over the estimated remaining periods to maturity of the investments sold. The extent of the impact of the interest maintenance reserve depends on the amount of future interest-rate related realized capital gains and losses on fixed maturity investments.

The National Association of Insurance Commissioner Ratios

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners annually calculates twelve financial ratios to assist state regulators in monitoring the financial condition of insurance companies. A usual range of results for each ratio is used as a benchmark and departure from the usual range on four or more of the ratios can lead to inquiries from individual state insurance departments.

Two Jackson National Life ratios fell outside the usual range in 2001. The first was the net income to total income ratio which fell outside the usual range because of the net loss reported for 2001. The net loss resulted from realized capital losses. Although the statutory gain from operations was $193 million, it was more than offset by $394 million of realized investment losses. Any net loss is considered unusual for this ratio. The second was the change in premium ratio which fell outside the usual range because total premiums reported were lower than the prior year. Premiums decreased from a record high $8,903 million in 2000 to $7,990 million in 2001. This 10.3% decrease in total premiums is just outside of the acceptable range of a 50% increase to a 10% decrease.

Policy and Contract Reserve Sufficiency Analysis

Michigan insurance law requires Jackson National Life to conduct annually an analysis of the sufficiency of interest-sensitive life and annuity reserves. A qualified actuary must submit to the insurance department an opinion that states that the reserves, when considered in the light of the assets that an insurance company holds with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurance company. If a qualified actuary cannot provide such an opinion, then the insurance company must set up additional reserves by moving funds from unassigned surplus. The 2001 opinion is not due yet. However Jackson National Life expects to provide the required 2001 opinion to the insurance department without any qualifications.

Jackson National Life's Capital and Surplus

Michigan insurance law requires Jackson National Life, as a domestic stock life insurance company, to maintain at least US$7,500,000 in unimpaired capital and surplus. In addition, insurance companies are required to have sufficient capital and surplus to be safe, reliable and entitled to public confidence.

As a licensed insurer in the District of Columbia and every state but New York, where it operates through a subsidiary, Jackson National Life is subject to the supervision of the regulators of each such jurisdiction. In connection with the continual licensing of Jackson National Life, regulators have discretionary authority to limit or prohibit new issuance of business to policyholders when, in their judgment, the regulators determine that such insurer is not maintaining minimum surplus or capital or if further transaction of business will be hazardous to policyholders.

Risk-based Capital

In 1992, the National Association of Insurance Commissioners approved risk-based capital standards for life insurance companies as well as a model act for state legislatures to enact. The model act requires that life insurance companies report on a formula-based, risk-based capital standard that they calculate by applying factors to various asset, premium and reserve items. The formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk and business risk. The National Association of Insurance Commissioners designed the formula as an early warning tool to identify potentially inadequately capitalized companies for purposes of initiating regulatory action. The National Association of Insurance Commissioners intended the formula as a regulatory tool only and did not intend it as a means to rank insurers generally. The model act imposes broad confidentiality requirements on those engaged in the insurance business (including insurers, agents, brokers and others) and on state insurance departments as to the use and publication of risk-based capital data.

The model act gives the state insurance commissioner of any state adopting it explicit regulatory authority to require various actions by, or take various actions against, insurance companies whose adjusted capital does not meet minimum risk-based capital standards. The Michigan insurance commissioner takes into account the National Association of Insurance Commissioners' risk-based capital standards to determine adequate compliance with Michigan insurance law. At December 31, 2001, Jackson National Life's total adjusted capital under the National Association of Insurance Commissioners' definition substantially exceeded model act standards.

Regulation of Investments

Jackson National Life is subject to state laws and regulations that require diversification of its investment portfolio, limit the amount of investments in certain investment categories such as below investment grade fixed income securities, equity real estate, foreign securities and common stocks and forbid certain other types of investments altogether. Jackson National Life's failure to comply with these laws and regulations would cause investments exceeding regulatory limitations to be treated by the Michigan Insurance Division as non-admitted assets for purposes of measuring surplus, and, in some instances, the Michigan Insurance Division could require divestiture of such non-qualifying investments.

Federal Financial Services Regulation

On November 12, 1999, the US president signed into law the Gramm-Leach-Bliley Act ("Gramm-Leach") which eliminated certain barriers to and restrictions on affiliations among banks, securities firms, insurance companies and other financial services organizations. Gramm-Leach permits bank holding companies, US banks and, in some cases, foreign banking organizations that meet certain criteria relating to capital, management and (for US institutions) service to low-income and moderate-income communities to engage through affiliates in a wider range of financial activities, including securities underwriting and dealing, mutual fund distribution and merchant banking investing. Bank holding companies and foreign banking organizations that meet these criteria can elect to become "financial holding companies" to take advantage of these broader powers.

While Gramm-Leach relaxes restrictions on affiliations of banks with other types of financial companies, it generally leaves in place restrictions on affiliations between banks and commercial firms. In addition, Gramm-Leach imposes new restrictions on affiliations between savings associations, or "thrifts," and commercial firms. Before Gramm-Leach, commercial companies were permitted to own a single thrift under certain conditions and were regulated as "unitary thrift holding companies" by the Office of Thrift Supervision. After Gramm-Leach, commercial companies are generally prohibited from acquiring or establishing even a single thrift.

Jackson National Life acquired a thrift before Gramm-Leach and thereby achieved a "grandfathered unitary thrift holding company" status for itself and for Prudential plc. See " Business of Prudential US Business Jackson Federal Bank" in this Item 4. Grandfathered unitary thrift holding company status offers superior affiliation powers than are authorized under Gramm-Leach for financial holding companies. Gramm-Leach does not impose any affiliation restrictions on grandfathered unitary thrift holding companies. Thus, right now, if Jackson National Life or its holding companies wanted to acquire, for example, a computer chip maker or a grocery store, in the US or overseas, there would be no barrier to such a transaction under US banking laws.

However, this privilege exists only so long as the holding company preserves its status as a grandfathered unitary thrift holding company. The primary restrictions in this regard are that the holding company cannot undergo a change in control or acquire a separate US bank or thrift (unless the acquired institution is merged with the existing thrift subsidiary, Jackson Federal Bank).

Besides the general lack of restriction on affiliations, the other major consequences of being a grandfathered unitary thrift holding company is that the holding company is subject to the supervisory regime of the Office of Thrift Supervision ("OTS") rather than that of the Federal Reserve Board. In general, the OTS exercises relatively less supervisory oversight over unitary thrift holding companies than the Federal Reserve Board exercises over financial holding companies. See " Supervision and Regulation of Prudential US Supervision and Regulation Thrift Regulation" in this Item 4.

On the other hand, because Jackson National Life and its holding companies are not currently engaged in commercial activities, Jackson National Life has the power to choose to become a "financial holding company" at a future date (e.g., by acquiring a bank or by converting Jackson Federal Bank into a bank), and thereby become subject to the Federal Reserve Board's regulatory regime, if Jackson National Life discerns an advantage to doing so. However, the status of "grandfathered unitary thrift holding company" would be irretrievably forgone.

While the full impact of Gramm-Leach is difficult to predict, there are a number of ways in which the law may affect Jackson National:

- Jackson National Life may face additional competition from larger financial services companies because banks, securities firms and insurance companies, both in the US and those currently engaged in such activities offshore, may affiliate with and form organizations that compete with Jackson National Life's businesses. In the years since Gramm-Leach was adopted, there have not been many mergers between banks and insurers, perhaps because insurers have been reluctant to subject themselves to the supervision of the Federal Reserve Board, and because US banks may be reluctant to dilute their return on equity, which is generally higher than that of US insurers. This could change, however, as economics change and as Federal Reserve Board supervision of insurers becomes more well-defined.

- Bank acquisitions of insurance agencies have accelerated (because Gramm-Leach added empowerments to prior law, which generally limited banks to selling insurance from places with populations of less than 5,000), intensifying the strategic importance of efforts to sell Jackson National Life products through banks and bank affiliates.

- Gramm-Leach requires all financial services providers to comply with new privacy requirements, including a provision permitting customers to decide not to permit financial providers to share non-public personal information with third parties who seek to market to these customers. All of Jackson National Life's companies are subject to this requirement, but the requirement has not added significant costs or competitive burdens.

Securities Laws

Jackson National Life, certain of its affiliates and certain policies and contracts that Jackson National Life offers are subject to various levels of regulation under the federal securities laws that the Securities and Exchange Commission administers.

The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations. Jackson National Life may also be subject to similar laws and regulations in the states in which it provides investment advisory services, offers the products described above or conducts other securities-related activities.

Jackson National Asset Management LLC is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940 and a transfer agent under the Securities Exchange Act of 1934 (the "Securities Exchange Act"). The mutual funds for which Jackson National Asset Management LLC serves as investment adviser are subject to regulation under the Securities Act of 1933 (the "Securities Act") and the Investment Company Act of 1940 (the "Investment Company Act"). In addition, variable annuities and the related separate accounts of Jackson National Life are subject to regulation by the Securities and Exchange Commission under the Securities Act and the Investment Company Act as well as applicable insurance laws.

Each of Jackson National Life Distributors, Inc., National Planning Corporation, SII Investments, Inc., INVEST, and ICA is registered as a broker-dealer under the Securities Exchange Act. National Planning Corporation was formerly known as Jackson National Financial Services, Inc. Jackson National Life Distributors, National Planning Corporation and SII Investments are subject to regulation and supervision by the Securities and Exchange Commission, state securities authorities (to the extent that they transact business in that state), and the National Association of Securities Dealers, Inc., each of which has broad administrative and supervisory powers relative to all aspects of the broker-dealer business and may examine a broker-dealer's business and accounts at any time.

Prudential also conducts US investment management activities through PPM America, Inc., which is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940. PPM America, Inc. serves as the investment adviser to Jackson National Life, certain mutual funds, several private investment funds and structured finance vehicles, and the US equity and fixed income portions of portfolios of certain UK affiliates of PPM America, Inc. The mutual funds for which PPM America, Inc. serves as investment adviser or sub-adviser are subject to regulation under the Securities Act and the Investment Company Act.

PPM America, Inc. and certain of its subsidiaries are subject to various levels of regulation under the federal securities laws that the Securities and Exchange Commission administers. The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations.

To the extent that PPM America, Inc. manages assets for certain types of employee benefit plans subject to ERISA, the Employee Retirement Income Security Act of 1974, certain activities of PPM America, Inc. are potentially subject to the same types of regulatory restrictions that ERISA and the Internal Revenue Code impose. Such restrictions are the same as those described with respect to Jackson National Life concerning Employee Benefit Plan Compliance. See "Employee Benefit Plan Compliance" in this section below. The Department of Labor and the Internal Revenue Service have interpretive and enforcement authority over these provisions of ERISA and the Internal Revenue Code.

Thrift Regulation

JNL Thrift Holdings, Inc. ("Thrift Holdings"), a subsidiary of Jackson National Life, is the immediate parent company and a unitary thrift holding company for Jackson Federal Bank, a federally chartered savings association, or "thrift". Each of Thrift Holdings and, to a greater extent, Jackson Federal Bank is subject to supervision and regulation by the OTS, a component of the US Department of the Treasury (an agency of the US federal government). The OTS is the primary federal regulator of Thrift Holdings and Jackson Federal Bank.

As described above, Thrift Holdings generally is not subject to restrictions on its ability to affiliate with financial or commercial companies because it is a grandfathered unitary thrift holding company. See "Supervision and Regulation of Prudential US Supervision and Regulation Federal Financial Services Regulation" in this Item 4. However, Thrift Holdings (as well as its parent companies Jackson National Life and Prudential) could become subject to restrictions on their activities and investments if Jackson Federal Bank were to fail to be a "qualified thrift lender" ("QTL") under the Home Owners' Loan Act ("HOLA").

In general, in order for Jackson Federal Bank to remain a QTL, a certain percentage of its assets must consist of residential real estate mortgage loans, consumer loans, small business loans and other similar and related assets. Jackson Federal Bank is currently in compliance with QTL standards. In addition to triggering restrictions on activities of affiliates, failure to remain a QTL would also trigger restrictions on the ability of Jackson Federal Bank to obtain funding from the Federal Home Loan Bank System, establish new branches and pay dividends.

Under HOLA and applicable OTS regulations, thrift holding companies must file periodic reports with the OTS and must comply with OTS recordkeeping requirements. Thrift holding companies are subject to holding company examination by the OTS, and the OTS may take enforcement action against a thrift holding company if the activities of the thrift holding company constitute a serious risk to the financial safety, soundness or stability of a subsidiary thrift. Thrift holding companies are not subject to OTS capital adequacy requirements.

Jackson Federal Bank is subject to extensive regulation and examination by the OTS under HOLA and other federal laws and regulations. These laws and regulations govern Jackson Federal Bank's lending, deposit-taking and other activities, establishment of branches, transactions with affiliates (including Thrift Holdings and Jackson National Life), payment of dividends, capital adequacy and "community reinvestment" activities (which include lending to low-income and moderate-income communities).

Jackson Federal Bank is also subject to reserve requirements relating to its deposit activities under the Federal Reserve Act, as administered by the Federal Reserve Board, and is subject to regulation and supervision by the Federal Deposit Insurance Corporation, which insures certain of Jackson Federal Bank's deposits.

Employee Benefit Plan Compliance

Jackson National Life issues certain types of general account stable value products, such as GICs and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. To a large extent, these plans are retirement plans that are subject to the fiduciary standards of ERISA, and that are tax qualified under the Internal Revenue Code. As such, certain activities of Jackson National are potentially subject to certain regulatory restrictions that ERISA and the Internal Revenue Code impose. These restrictions include:

- the requirement under ERISA that fiduciaries must perform their duties solely in the interests of ERISA plan participants and beneficiaries,
- the requirements under ERISA and the Internal Revenue Code that fiduciaries may not engage in conflict of interest transactions, and
- the requirements under ERISA and the Internal Revenue Code that a fiduciary may not cause a covered plan to engage in certain prohibited transactions with certain persons who provide services to the plan or are affiliated with the plan sponsor or a plan service provider.

The Department of Labor and the Internal Revenue Service have interpretive and enforcement authority over these provisions of ERISA and the Internal Revenue Code.

In the instance where an insurer issues a guaranteed benefit policy to a plan, ERISA provides that the insurer need not become a fiduciary with respect to the plan solely as a result of the issuance of the policy. Under Section 401 of ERISA, a guaranteed benefit policy means an insurance policy to the extent such policy provides for benefits the amount of which the insurer guarantees.

In 1993, in *John Hancock Mutual Life Insurance Company v. Harris Trust & Savings Bank*, the US Supreme Court held that, with respect to a portion of the funds held under a general account group annuity contract, an insurer could be subject to the fiduciary requirements of ERISA and the prohibited transaction provisions of ERISA and the Code. This decision was in contradiction to interpretations that the Department of Labor had previously issued.

As part of the Small Business Job Protection Act of 1996, Congress offered some relief from the impact of the *Harris Trust* decision for certain policies issued on or before December 31, 1998. This Act also required the Department of Labor to issue regulations for the purpose of determining, in cases where an issuer issues general account policies to or on behalf of employee benefit plans, which assets of the insurer will be subject to the fiduciary responsibility and prohibited transaction provisions of ERISA. In addition, the Act provided some protection from lawsuits claiming breaches of fiduciary duties under ERISA for actions arising prior to the finalization of such regulations for policies.

Nonetheless, the relief provided by the Small Business Job Protection Act is only transitional and the Department of Labor has not to date provided detailed guidance on the application of the *Harris Trust* decision to a determination of whether one or more policies will qualify as a guaranteed benefit policy. Accordingly, although Prudential does not believe that the *Harris Trust* decision will have a material adverse effect on Jackson National Life's business, financial condition or operations results, and Jackson National Life is proceeding with its general account products with the understanding that their issuance will not alone make Jackson National Life subject to ERISA's fiduciary standards and prohibited transaction provisions, the full impact of the *Harris Trust* decision is not entirely clear.

In addition, for plans that are not subject to ERISA or the prohibited transaction provisions of the Internal Revenue Code, such as pension plans maintained by state or local governments, state and local laws may apply in lieu of these fiduciary standards. Although Prudential does not believe that such laws will have a material adverse effect on Jackson National Life's business, financial condition or operations results, the application of these laws is generally less developed than the federal pension laws.

Financial Services Regulatory and Legislative Issues

The US President has in the past proposed to increase the taxes levied against the insurance industry to increase the federal budget. The industry has been very successful in resisting these proposals on the grounds that an increase in taxes on insurance companies or insurance policies would have a negative affect on US citizens saving for their retirement. The insurance industry is very vigilant in monitoring these proposals and taking action to oppose them.

States regulate the business of insurance and each state regularly enacts or promulgates legislation and regulations that affect the way insurers do business within the state's boundaries. A major issue at the state level involves genetic information and whether insurers should be able to use such information when underwriting insurance policies. Many states have passed legislation restricting a health insurer's ability to use this information, but, at present, life insurance companies have not been made subject to similar restrictions. Prudential expects that similar legislative initiatives will continue to be passed into law.

Item 5. Operating and Financial Review and Prospects

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with Prudential's consolidated financial statements and the related notes to Prudential's consolidated financial statements included elsewhere in this document. Prudential's consolidated financial statements have been prepared in accordance with UK GAAP, which differs in certain material respects from US GAAP. For a summary of the material differences between UK GAAP and US GAAP relevant to Prudential's financial statements, see Notes 37 and 38 of the notes to Prudential's consolidated financial statements. A summary of the critical accounting policies which have been applied to these statements is set forth in the section below entitled " 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 section below entitled " Factors Affecting Results of Operations", in Item 3, "Key Information Risk Factors" and elsewhere in this document.

Introduction

Prudential provides a broad range of financial products and services, primarily to the retail market. The period since 1999 has been one of significant change as Prudential has positioned itself to compete and succeed in the new millennium.

In 1999, Prudential completed the acquisition of M&G, expanded its Asian and European operations, further developed Egg plc, a direct marketing banking operation, and reorganized its UK retail and fund management operations.

In 2000, Prudential completed its listing on the New York Stock Exchange, and completed an initial public offering of Egg plc on the London Stock Exchange.

In 2001, Prudential restructured its UK Insurance Operations resulting in a charge to shareholders of £48 million. The restructuring is expected to result in annual gross savings of approximately £175 million from 2004. See "Item 4 Information on the Company Business of Prudential UK Operations Restructuring". In addition, Prudential announced an all-share merger with American General Corporation in February 2001, which was terminated in May 2001. In accordance with the merger agreement, American General paid Prudential the full termination fee of £423 million (US$600 million) required under the contract. See Item 4, "Information on the Company Information Regarding Merger with American General Corporation". In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance business to Winterthur Insurance and the Churchill Group, its UK subsidiary. On December 31, 2001, these insurance liabilities were almost wholly reassured to Winterthur. The sale was completed on January 4, 2002 for a consideration of £353 million. Profits from Prudential's UK personal lines property and casualty business have been classified as discontinued operations for 2001. See "Item 4 Information on the Company Business of Prudential UK Business Personal Lines, Property and Casualty Insurance Transfer of Business to Winterthur".

Factors Affecting Results of Operations

Prudential's results of operations are affected, to a greater or lesser degree, by a variety of factors, including demographics, general economic and market conditions, government policy and legislation and regulation, as discussed in greater detail below. See Item 3, "Key Information Risk Factors" for more information on risks associated with these and other factors. In addition, changes to the composition of its businesses and the execution of its growth strategy may result in increased variation in profits from year to year.

General Economic and Market Conditions

In the 1990s, retail financial services and fund management markets in the United Kingdom and the United States benefited from generally favorable economic and market conditions. During that period, both the United Kingdom and the United States experienced strong economic growth, stable interest rates, low inflation rates and very strong growth in stock market prices. However over the last few years, these markets have experienced significant volatility. Despite these recent fluctuations, Prudential believes that the historical strength of the UK and US equity markets, combined with demographic factors and governmental efforts to increase individual savings and self-provision for retirement, has resulted in increased consumer focus on savings and investment products.

Meanwhile, in Asia the global economic slowdown is likely to depress short-term growth rates. However, in the long term, Prudential believes potential in Asia remains exceptional and that with its significant portfolio of businesses in the region, multi-channel distribution capabilities, excellent strategic partners and customer-focused product expertise it is in a very healthy position to benefit from the strong growth potential throughout Asia.

Changes in interest rates and returns from equity, real estate and other investments as well as volatility in these items may affect Prudential's profitability. In the United Kingdom, where Prudential invests in debt and other fixed income securities, equity securities and real estate, shareholders' profits under UK GAAP are largely a function of the bonuses it declares on with-profits products. The most important influences on the bonus rates are the overall rate of return earned on investments and Prudential's expectation of future investment returns. See "Analysis of Geographic Region UK Operations Basis of Profits", " With-Profits Products" and " Bonus Rates" below. In recent years, Prudential's long-term expectations of lower investment returns have had a negative impact on annual bonus rates and, as a result, shareholders' profit. A sustained fall in equity markets would have a negative impact on terminal bonus rates and, consequently, shareholders' profit. Prudential's bonus policy and its impact on profitability is addressed in more detail in "Critical Accounting Policies" below.

In the United States, fluctuations in prevailing interest rates, including changes in the difference between the levels of prevailing short-term and long-term rates, can affect results from Jackson National Life, which is predominantly a spread-based business with the majority of its assets invested in fixed income securities. Changes in interest rates, either upward or downward, can expose Jackson National Life to the risk of not earning anticipated spreads between the rate earned on investments and the rate credited on its policies. For example, if interest rates go up and/or competitors offer higher crediting rates, withdrawals on annuity contracts may increase as policyholders seek higher investment returns elsewhere. In response, Jackson National Life could (1) raise its crediting rates to stem withdrawals, decreasing its spread; (2) sell assets which may have depressed values in a high interest rate environment, creating realized investment losses; or (3) pay out existing cash which would otherwise have earned interest at the higher interest rates. Moreover, to the extent that Jackson National Life holds illiquid private placements and commercial mortgages, there is a risk that it will incur losses if it needs to sell those assets. Conversely, if interest rates decrease, withdrawals from annuity contracts may decrease relative to original expectations, creating more than expected cash to be invested at lower rates. Jackson National Life may have the ability to lower the rates it credits to policyholders as a result, but may be forced to maintain crediting rates for competitive reasons or because there exist minimum interest rate guarantees in certain contracts. In either case, the spread earned by Jackson National Life would be lowered.

The profitability of Jackson National Life's spread-based businesses depends in large part on its ability to manage interest rate spreads, as well as the credit and other risks inherent in its investment portfolio. There can be no guarantee that these risks will be managed successfully. Prudential designs its US products and manages the investments supporting this business to reduce interest rate sensitivity. This has the effect of moderating the impact on Prudential's results of changes in prevailing interest rates. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk" for a discussion of the management of Prudential's exposure to such market risk.

Government Policy and Legislation

Changes in government policy or legislation applying to companies in the financial services and insurance industries in any of the jurisdictions in which Prudential operates, particularly in the United Kingdom and the United States, may adversely affect the result of its operations. These include possible changes in the tax treatment of financial products and services, government pension arrangements and policies, the regulation of selling practices and solvency standards. These changes may affect Prudential's existing and future business by, for example, causing customers to cancel existing policies, requiring Prudential to change its range of products and services, redesign its technology or other systems, retrain staff, pay increased tax or incur other costs.

Regulation

In recent years, the insurance sectors in the markets in which Prudential operates have faced increased scrutiny. In 1997, Prudential was publicly criticized by its UK regulators for its treatment of pensions mis-selling and for failures to adequately monitor and train its salesforce. In 2001, a fine of £650,000 was levied by the Personal Investment Authority, following an inspection in 1999 of Prudential's Phase 1 procedures, which revealed instances of delay in making payments of redress and of deficiencies in its record keeping. Pensions mis-selling is discussed in more detail under Item 4, "Information on the Company Business of Prudential UK Business Compliance Pensions Mis-selling". Additional regulation, scrutiny and related costs have put pressure on the margins on new business. In the United States, Prudential has been the subject of regulatory sanctions and class actions. These class actions are discussed in more detail under Item 4, "Information on the Company Business of Prudential Legal Proceedings". Changes in pensions, financial services and tax regulation could have an impact on Prudential's results. See Item 4, "Information on the Company Supervision and Regulation of Prudential" for a summary of the current regulatory environment in which Prudential conducts its business.

Exchange Rates

Due to the geographical diversity of Prudential's businesses, it is subject to the risk of exchange rate fluctuations. Prudential's international operations in the United States, Asia and Europe, which represent a significant proportion of total group income and expenses, generally write policies and invest in the same local currency, which although limiting the effect of exchange rate fluctuations on local operating results, can lead to fluctuations in Prudential's consolidated financial statements upon translation of results into pounds sterling.

UK GAAP 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 accounting principles generally accepted in the United Kingdom. The preparation of these financial statements requires Prudential to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, Prudential evaluates its estimates, including those related to long-term business provisioning, the fair value of assets and the declaration of bonus rates. Prudential bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 3 of the notes to the consolidated financial statements and "US GAAP Analysis US GAAP Critical Accounting Policies" below.

Long-term Business Provision

At December 31, 2001 the long-term business provision represented 63% of Prudential's total liabilities. These liabilities predominantly relate to with-profits and other protection type policies. These liabilities are estimated using actuarial methods based on assumptions relating to premiums, interest rates, investment returns, expenses, mortality and surrenders. If actual experience differs from these assumptions then the value of the liabilities would need to be adjusted.

With-profits Fund

The excess of assets over liabilities of the Group's long-term with-profits funds are retained within the fund for future appropriations and excluded from equity. Similarly excesses and deficits of net income over the UK basis surplus for distribution to policyholders and shareholders is transferred to, or from, the fund for future appropriations.

Fair Value of Assets

Equity securities, debt and other fixed income securities, except for those held by Jackson National Life (which are carried at amortized cost), are carried at fair value with unrealized gains and losses being reflected in the profit and loss account. Fair value is based on market prices for listed securities and on quotations provided by external fund managers, brokers, independent pricing services or values determined by management for unlisted securities.

Investments in real estate are carried at estimated fair value with changes in the fair value being recognized in the profit and loss account. Properties are valued annually either by the group's qualified surveyors or professional external valuers.

Bonus Rates

As outlined in basis of profits below, Prudential's results include an annual profit distribution to shareholders from long-term with-profits funds that represents an amount of up to one-ninth of the value of that year's bonus declarations to policyholders. The boards of directors of the subsidiary companies with with-profit operations with the advice of their appointed actuary, determine the amount of annual and terminal bonuses to be declared each year on each group of contracts. More detail on Prudential's bonus policy is set out in "Analysis by Geographic Operations UK Operations Basis of Profit".

Investment Returns

Investment returns comprise investment income, realized gains and losses and changes in unrealized gains and losses, except for changes in unrealized gains and losses on debt securities held by Jackson National Life. These securities are carried in the balance sheet at amortized cost. For debt and other fixed interest securities held by Jackson National Life, purchase premiums and discounts are amortized based on the underlying investments' call or maturity dates and this amortization is included in investment returns. Realized gains and losses, including writedowns on permanent dimunitions, are recognized in income on the date of sale as determined on a specific identification basis for Jackson National Life and on an average cost basis elsewhere.

Deferred Acquisition Costs

In common with other insurers Prudential incurs significant costs in connection with acquiring new insurance business. These costs, which vary with and are primarily related to the production of new business, are capitalized and amortized against margins in future revenues on the related insurance policies. The recoverability of the asset is measured and the asset is deemed impaired if the projected future margins are less than the carrying value of the asset. Management makes assumptions as to whether certain costs should be deferred or not and whether they will be offset by future margins on the policies. To the extent that the actual future margins differ from those anticipated then an adjustment to the carrying value of the deferred acquisition cost asset will be necessary.

The deferral and amortization of deferred acquisition costs is of most relevance to the Group's reported profits for shareholder financed long-term business operations, principally Jackson National Life in the United States. For with-profits funds the accounting policy for acquisition costs had no direct impact on profit due to the aforementioned treatment of the excess of assets over liabilities.

Overview of Consolidated Results

The following table shows Prudential's consolidated total profit on ordinary activities for the periods indicated.

	Year Ended December 31,		
	2001	**2000[1]**	**1999[1]**
	(In £ Millions)		
Operating profit before amortization of goodwill and tax[2]			
Continuing operations:			
UK operations	**422**	438	391
US operations	**298**	466	451
Asian operations	**25**	36	27
European operations	**(24)**	(10)	6
Group activities	**(130)**	(123)	(90)
UK restructuring	**(41)**		(58)
Total continuing operations	**550**	807	727
Discontinued operations			
Personal lines property and casualty insurance	**79**	33	61
UK restructuring	**(7)**		(12)
Total discontinued operations	**72**	33	49
Operating profit before amortization of goodwill and tax	**622**	840	776

	Year Ended December 31,		
Amortization of goodwill	**(95)**	(84)	(54)
Short-term fluctuations in investment returns	**(480)**	(48)	28
American General break fee net of expenses	**338**		
Profit on flotation of Egg and business disposals		239	
Total profit on ordinary activities before tax	**385**	947	750
Tax on profit on ordinary activities			
Tax on operating profit before amortization of goodwill	**(174)**	(260)	(269)
Tax on items excluded from operating profit before amortization of goodwill	**153**	(54)	(9)
Total tax on profit on ordinary activities	**(21)**	(314)	(278)
Profit on ordinary activities after tax before minority interests	**364**	633	472
Minority Interests	**25**	24	
Profit on ordinary activities after tax and minority interests	**389**	657	472

(1) Results for 2000 and 1999 have been restated to reflect the adoption of new UK GAAP policies concerning deferred tax in 2001. See Note 4 of the notes to Prudential's financial statements for a description of the new policies and the impact of adoption. All following statements in this Item 5 have been restated.

(2) Due to the long-term nature of Prudential's business, the basis of presentation of operating profit may not be comparable with other UK companies. See Note 5 of the notes to Prudential's consolidated financial statements for a description of the basis.

Profit Before Tax

Total profit on ordinary activities before tax in 2001 was £385 million compared with £947 million in 2000. The decrease in 2001 reflects a £168 million reduction in profits from Jackson National Life in the United States and a £432 million decrease in short-term fluctuations in investment returns primarily due to defaults and impairments on bonds in the United States. These losses were partially offset by £ 338 million net of related expenses representing the American General merger termination break fee. Goodwill amortization of £95 million in 2001 was £11 million higher than 2000 primarily due to a full year charge in relation to acquisitions in Taiwan and of US broker dealer operations.

Total profit on ordinary activities before tax in 2000 was £947 million compared with £750 million in 1999. The increase in 2000 primarily relates to profit on business disposals of £239 million resulting from the sale of shares and flotation of a minority holding in Egg plc of £119 million, the profit on the sale of Prudential's holding in St. James's Place Capital plc of £99 million and Prudential's share of the profit on the sale of a Bermudan fund manager held by St. James's Place Capital plc of £21 million. In 2000, profit before tax was adversely affected by an increase in goodwill amortization of £30 million, mainly due to a full twelve months amortization in respect of the M&G acquisition and a £76 million decrease in short-term fluctuations in investment returns due to market declines.

Profit After Tax

Profit after tax before minority interests in 2001 was £364 million compared with £633 million in 2000 and £472 million in 1999. These movements reflect the movements in profit before tax in those years and effective tax rates of 5.5% in 2001, 33.2% in 2000 and 37.1% in 1999. The reduction in the effective tax rate in 2001 represents the effect of tax payable on the American General merger termination break fee being relieved against capital losses available to the Group and acquired during the year. The decrease in the effective tax rate in 2000 compared to

1999 primarily reflects non-taxable book gains on sales of subsidiaries and associates partially offset by an increase in capital gains and other non-deductible expenses in 2000.

Analysis by Geographic Region

Prudential focuses on operating profit before amortization of goodwill and tax by geographic region as the primary measure of current year performance. This excludes exceptional items, such as profits on business disposals, and includes the investment return for the UK shareholders' funds and personal lines property and casualty insurance business and Jackson National Life, using a longer term rate of return, rather than the actual return for the year, in accordance with UK GAAP and Association of British Insurers, or ABI, guidelines. The analysis and discussion below is based upon operating profit before amortization of goodwill and tax. Due to the long-term nature of Prudential's business, its basis of presentation of operating profits may not be comparable with other UK companies. See Note 5 of the notes to Prudential's consolidated financial statements for a description of this basis.

For all of Prudential's long-term insurance businesses (United Kingdom, United States, Asia and continental Europe), operating profit is generated principally from its in-force book of business. Prudential's in-force book is business written in earlier years and on which it continues to declare bonuses or credit interest to policyholders and generate profit for shareholders. These books of in-force business have been built up over many years with the result that, for Prudential's long-term insurance business, sales in any one year do not have a significant impact on shareholders' profit in that year, but may have an impact in subsequent years.

United Kingdom

Basis of Profits

In order to understand how Prudential's results are derived it is necessary to understand how profit emerges from its with-profits business.

Prudential's results comprise an annual profit distribution to shareholders from its UK long-term with-profits fund, hereafter the with-profits fund, as well as profits from its other businesses. Prudential's primary UK GAAP financial statements are prepared under the modified statutory basis of reporting as required by UK law. For most of its operations, other than its UK long-term insurance businesses, the modified statutory basis matches items of income and related expenditure within the same accounting period. This is achieved through the deferral of acquisition costs and application of the accruals concept.

Prudential also uses the achieved profits basis of reporting to measure value generated by its long-term insurance business. For a discussion of Prudential's results thereunder, see " Achieved Profit Basis" below. Profit from other businesses is identical under both the achieved and modified statutory bases of profits.

With-profits Products

For Prudential's UK long-term insurance business, the primary annual contribution to shareholders' profit comes from its with-profit products. With-profits products are designed to provide policyholders with smoothed investment returns through a mix of annual and terminal bonuses. Shareholders' profit in respect of bonuses from with-profit products represents an amount of up to one-ninth of the value of that year's bonus declaration to policyholders. The smoothing inherent in the bonus declarations provides for relatively stable annual shareholders' profit from this business.

Bonus Rates

The main factors that influence the determination of bonus rates are the return on the investments of the with-profits fund, the effect of inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. The overall rate of return earned on investments and the expectation of future investment returns are the most important influences on bonus rates. The assets backing the with-profits business are predominantly invested in equities. If the financial strength of the with-profits fund were adversely affected, then a higher proportion of fixed interest or similar assets might be held by the fund.

Fund For Future Appropriations

The annual excess of premiums and investment return over operating expenses, benefit provisions and claims payments within Prudential's with-profits fund that are not distributed in that year as bonuses and related shareholders' profit are transferred to the fund for future appropriations by a charge to the profit and loss account of the with-profits fund. Any shortfall in such amounts would result in a transfer from the fund for future appropriations by a credit to the profit and loss account of the long-term fund. Current year amounts in respect of premiums, investment return, operating expenses and unusual charges or credits do not directly affect the distribution of profit to shareholders from the with-profits business in that year. Current year claims, which include terminal bonus payments, do have an effect on shareholders' profit through the shareholders' proportion of the value of those terminal bonuses.

Surplus Assets and Their Use

The fund for future appropriations comprises amounts Prudential expects to pay to policyholders in the future, the related shareholder transfers and surplus assets. These surplus assets, which are described in more detail under Item 4, "Information on the Company Business of Prudential UK Business Shareholders' Interests in Long-term Insurance Business Surplus Assets in Prudential Assurance's With-profits Fund", have accumulated over many years from a variety of sources and provide the with-profits fund with working capital. This working capital permits Prudential to invest a substantial portion of the assets of the with-profits fund in equity securities and real estate, smooth investment returns to with-profit policyholders, keep its products competitive, write new business without being constrained as to cash flows in the early policy years and demonstrate solvency.

In addition, Prudential can use surplus assets to absorb the costs of significant events, such as fundamental strategic change in its long-term business and, as approved by the UK regulator, the cost of its pensions mis-selling, without affecting the level of distributions to policyholders and shareholders. The costs of fundamental strategic change may include investment in new technology, redundancy and restructuring costs, cost overruns on new business and the funding of other appropriate long-term insurance related activities including acquisitions.

The "SAIF" and "PAL" Funds

Prudential's with-profits fund also includes the results of two other businesses, the Scottish Amicable Insurance Fund ("SAIF") and Prudential Annuities Limited ("PAL"). All assets of the SAIF business are solely attributable to former policyholders of Scottish Amicable Life Assurance Society. The SAIF with-profits fund is discussed in more detail under Item 4, "Information on the Company Business of Prudential UK Business Shareholders' Interest in Prudential's Long-term Insurance Business The SAIF Sub-Fund and Accounts". PAL is a wholly-owned subsidiary of the with-profits fund, and, accordingly, profits from this business do not have a direct impact on shareholders' profits and affect shareholders' profits only to the extent that they affect the annual with-profits bonus declaration.

United Kingdom Operating Results

The following table shows operating profit before amortization of goodwill, tax and restructuring, for the periods indicated.

	Year Ended December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
Continuing operations			
UK Insurance Operations long-term business	**435**	468	454
Egg	**(88)**	(155)	(150)
M&G			
Long-term business		35	17
Other activities	**75**	90	70
M&G total	**75**	125	87
Total continuing operations	**422**	438	391
Discontinued operations			
Personal lines property and casualty operations	**79**	33	61
Total operating profit before amortization of goodwill, tax and restructuring	**501**	471	452

	Year Ended December 31,		

UK Insurance Operations

Operating profit from continuing operations before amortization of goodwill, tax and restructuring from UK Insurance Operations in 2001 totalled £435 million, compared with £468 million in 2000 and £454 million in 1999. The reduction in 2001 primarily reflected the effect of lower with-profits bonuses together with the one-off £30 million profit in 2000 relating to the transfer of the M&G life and pensions business to UK Insurance Operations.

In any single period the operating profit is primarily the shareholders' annual distribution from the with-profits fund which represents up to one-ninth of the value of bonuses declared in that year to policyholders, and consequently is not directly impacted by the current year gross premiums, investment income and expenses.

In 2001, Prudential declared total post-tax bonuses of £3,100 million from the with-profits fund of which £2,790 million was credited to with-profits policies and £310 million was distributed to shareholders. This reflects annual bonus rates of 4% for the Prudence Bond and 4.5% for personal pensions.

In 2000, Prudential declared total post-tax bonuses of £3,103 million from the with-profits fund, of which £2,796 million was added to with-profits policies and £307 million was distributed to shareholders. This reflected regular bonus rates of 4.5% for the Prudence Bond and 5% for personal pensions. In 1999, Prudential declared total bonuses of £3,040 million, of which £2,736 million was added to with-profit policies and £304 million was distributed to shareholders. This reflected regular bonus rates of 4.75% for the Prudence Bond and 5.25% for personal pensions. The remaining profits reflected distributions from other with-profits funds and from unit-linked businesses.

All unit-linked business written by Prudential or Scottish Amicable in the United Kingdom is written against capital provided by shareholders. All profit from this business goes to shareholders.

M&G

M&G's total operating profit in 2001 before amortization of goodwill and tax decreased by £50 million, from £125 million in 2000 to £75 million in 2001. This was mainly as a result of the transfer of M&G's life and pensions business to UK Insurance Operations, which contributed £35 million to M&G's total operating profit in 2000.

In 2000, M&G's total operating profit was £125 million, £38 million greater than in 1999. This increase was primarily due to the inclusion of M&G for a full year in 2000 compared with only eight months in 1999 and increased fees from Prudential's internal funds as a result of outperformance by the investments supporting the funds against benchmarks.

Egg

Egg's operating loss before amortization of goodwill and tax amounted to £88 million in 2001 compared to £155 million in 2000 and £150 million in 1999.

The loss of £88 million reflects operating income of £189 million, compared to £93 million in 2000, offset by expenses of £273 million, compared to £247 million in 2000. The increase in operating income reflects both an increase in net interest income of £66 million to £146 million, resulting from an increase in the net interest margin, and a £30 million increase in other operating income, to £44 million, primarily reflecting fees and commissions earned from unsecured lending products. Higher expenses in 2001 were largely due to a £31 million increase in the bad debt charge to £68 million, reflecting the significant growth in credit card balances.

Net interest income from banking products in 2000 was £80 million, compared to £24 million in 1999. This increase reflected a reduction in the interest rate paid on customer deposits as well as a reduction in total customer deposits. Operating and administrative expenses for Egg totaled £247 million in 2000, an increase of £77 million over 1999. This increase in expenses was primarily due to an increase in brand, marketing and development costs of £35 million and an increase in the provision for doubtful debts of £28 million.

Personal Lines Property and Casualty Operations

Operating profit before amortization of goodwill and tax from personal lines property and casualty operations increased from £33 million in 2000 to £79 million in 2001. This was primarily attributable, in turn, to the combined claims and expense ratio (excluding credit business) decreasing to 91% in 2001 from 101% in 2000. This decrease was primarily attributable to higher claims in 2000 due to floods in the second half of the year. The high claims rate in 2000 caused profits to decrease from £61 million in 1999 to £33m in 2000. The claims and expense ratio in 1999 was 89%.

In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance business to Winterthur Insurance and the Churchill Group, its UK subsidiary. On December 31, the insurance liabilities were almost wholly reassured, to Winterthur Insurance. The related cash transfer for this reinsurance was offset in January 2002 against the sales proceeds of this business. The sale was completed on January 4, 2002 for a consideration of £353 million. After allowing for the costs of the sale and other related items it is anticipated that profit on sale recorded in the 2002 results will be approximately £360 million before tax. In addition Prudential anticipates the release of approximately £200 million of solvency, capital and approximately £21 million of net profits in the unearned premium reserve, and receiving £236 million in relation to the conservatively estimated net present value of future commissions and profits over the term of the agreement. Profits from Prudential's UK personal lines property and casualty business have been classified as discontinued operations for 2001. In 2001 this business had operating profits before amortization of goodwill and tax of £79 million. See Item 4, "Information on the Company Business of Prudential UK Business Units Personal Lines Property and Casualty Insurance Transfer of Business to Winterthur".

United States

Prudential's US operations comprise its US insurance company, Jackson National Life, which includes Jackson Federal Bank, PPM America, its US internal and institutional investment manager, and its US broker-dealer, National Planning Holdings.

Basis of Profits

The profit on Jackson National Life's business predominantly arises from spread income from interest-sensitive products, such as fixed annuities and stable value products. For the purposes of UK reporting, deposits into these products are recorded as premiums, withdrawals and surrenders are included in benefits and claims and the resulting net movement is recorded under other reserve movements within benefits and claims. Benefits and claims also includes interest credited to policyholders in respect of deposit products and fees charged on these policies. While the presentation of these items differs between UK GAAP and US GAAP, there is no net impact on operating profit. The UK GAAP result for Jackson National Life is based on Jackson National Life's US GAAP results with an adjustment for FAS 133 "Accounting for Derivative Instruments and Hedging Activities" as amended by FAS 137 and 138, and for a different treatment of investment gains and losses.

United States Operating Results

The following table shows operating profit before amortization of goodwill and tax for the periods indicated.

	Year Ended December 31,		
	2001	**2000**	**1999**
	(In £ Millions)		
Jackson National Life	**282**	459	457
National Planning Holdings	**(4)**		(4)
PPM America	**20**	7	(2)
Total operating profit before amortization of goodwill and tax	**298**	466	451

Operating profit before amortization of goodwill and tax of £298 million in 2001 was £168 million lower than in 2000. The decline principally reflects reduced spread income (the difference between the amounts that Jackson National Life is required to pay, and the rate of return it is able to earn on its investments) combined with a £67 million charge in the current year in relation to average realized gains and losses on bonds (as realized gains and losses on bonds are taken through operating profit on a five year averaging basis). Lower spread income reflects lower investment returns and the fact that Prudential did not, in the increasingly competitive market, fully reset policyholder crediting rates to compensate. Fee income was lower due to lower sales and lower account values for variable annuities.

In 2000, operating profit before amortization of goodwill and tax from US operations was £466 million, consistent with 1999 operating profit before tax of £451 million.

The exchange rate between the US dollar and pound sterling has remained relatively constant during 1999 through 2001, therefore exchange rate fluctuations have had limited impact on the results of Prudential's US operations.

Asian Operations

The relatively recent growth of Prudential's Asian operations and the deferred emergence of profits from its long-term insurance business means that these businesses currently make only a small contribution to group operating profit before amortization of goodwill and tax.

	Year Ended December 31,		
	2001	2000	1999
	(In £ Millions)		
Asian operations	**25**	36	27

Operating profit before amortization of goodwill, tax and minority interests from Prudential's Asian operations in 2001 was £25 million, a decrease of £11 million over 2000. This movement primarily reflects an increase in development costs of £16 million, from £3 million in 2000 to £19 million in 2001. The development spend of £19 million reflects increased project-related expenses and merger and acquisition activity in the region, combined with a brand launch and start-up costs associated with PCA Life in Japan. The underlying Asian performance (operating profit before development costs, amortization of goodwill and tax) improved by £5 million to £44 million in 2001, reflecting strong performances from the established markets and regional fund management, offset by increased losses in developing markets including significant start up losses in Japan. Profits in 2000 rose by £9 million to £36 million compared to 1999, reflecting increased profits from established operations and fund management operations, offsetting losses from new and emerging operations. In 2001, Asian regional head office expenses of £24 million were reclassified as group activity expenditure. In 2000 and 1999 the regional head office expenses amounted to £14 million and £12 million of expenditure respectively.

European Operations

Operating profit before amortization of goodwill and tax from Prudential's European operations represents profits from Scottish Amicable Life International, an Irish company, which markets unit-linked products into Germany, France and the United Kingdom.

	Year Ended December 31,		
	2001	2000	1999
	(In £ Millions)		
European operations	**(24)**	(10)	6

Operating loss before amortization of goodwill and tax from Prudential's European operations was £24 million in 2001 compared to an operating loss before tax of £10 million in 2000 and an operating profit before tax of £6 million in 1999. The decrease in 2001 reflects development expenses incurred in the period of £29 million compared to £18 million in 2000, and no such expenses in 1999. Underlying European performance (operating profit before development costs, amortization of goodwill and tax) of £5 million in 2001 was £3 million lower than 2000.

Group Activities

Operating profit from group activities represents the longer-term investment return on centrally retained shareholder capital and funds, interest expense on group borrowings and central corporate expenditure.

Year Ended December 31,

	Year Ended December 31,		
	2001	2000	1999
	(In £ Millions)		
Group activities	**(130)**	(123)	(90)

Operating loss before amortization of goodwill and tax for group activities increased to £130 million in 2001 from £123 million in 2000 due to lower investment and other income not being completely offset by lower interest payable, and due to an increase in Asian regional head office expenses of £10 million to £24 million in 2001, reflecting the increased size of this business.

In 2000, operating loss before amortization of goodwill and tax for group activities increased from a loss of £90 million in 1999 to a loss of £123 million. This increase primarily reflects a £29 million increase in net investment expense to £67 million for 2000 compared to 1999, reflecting the full year funding cost related to the acquisition of M&G and additional funding for Egg in 2000 compared to 1999.

UK Restructuring

	Year Ended December 31,		
	2001	2000	1999
	(In £ Millions)		
UK restructuring	**(48)**		(70)

In February 2001, Prudential announced the restructuring of the direct sales force and customer service channels of its UK Insurance Operations. In November 2001, Prudential announced further details of changes to the future structure of those operations, in particular the intention to pursue a single brand strategy for life and pensions business including the integration of the Scottish Amicable operation under the Prudential brand. The changes also include a simplification of the organizational structure and plans for a significant reduction in operating costs. The total cost in 2001 of this restructuring was £200 million of which £48 million was borne by shareholders (with £41 million apportioned to continuing operations and £7 million to discontinued operations) and the remaining £152 million by the with-profits fund. These costs were allocated between the with-profits fund and shareholder businesses on the basis of the activity to which the costs relate.

In 1999, Prudential announced a restructuring program, principally relating to a reduction in its salesforce. The total cost of the 1999 restructuring was £148 million, of which £78 million was borne by the with-profits fund and the remaining £70 million borne by the shareholders. These costs were allocated between the with-profits fund and shareholder businesses on the basis of the activity to which the costs relate.

Geographic Analysis by Nature of Income and Expense

The following table shows Prudential's consolidated total profit on ordinary activities before amortization of goodwill, tax and minority interests for the periods indicated:

	Year Ended December 31,		
	2001	2000	1999
	(In £ Millions)		
Long-term business:			

	Year Ended December 31,		
Gross premiums	**15,196**	14,173	14,826
Reinsurance	**(180)**	(109)	(75)
Earned premiums	**15,016**	14,064	14,751
Investment returns	**(1,070)**	4,821	17,015
Expenses	**(2,098)**	(1,980)	(1,709)
Restructuring costs attributable to with-profits policyholders	**(152)**		(78)
Taxation within long-term business funds	**241**	(166)	(1,200)
Benefits and claims	**(19,160)**	(19,528)	(22,151)
Transfers from/(to) the fund for future appropriations	**7,754**		