PRUDENTIAL PLC
Form 20-F
March 22, 2018

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As filed with the Securities and Exchange Commission on 22 March 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended 31 December 2017

OR

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

OR

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

Commission File Number: 1-15040

PRUDENTIAL PUBLIC LIMITED COMPANY

(Exact Name of Registrant as Specified in its Charter)

England and Wales
(Jurisdiction of Incorporation)

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

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Head of Financial Accounting
Prudential plc
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Securities registered or to be registered pursuant to Section 12(b) of the Act:

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

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

None

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

None

The number of outstanding shares of each of the issuer's classes of capital or common stock as of 31 December 2017 was:

2,587,175,445 Ordinary Shares, 5 pence par value each

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

Yes __X__ No ____

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

Yes ____ No __X__

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes __X__ No ____

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

Yes _____ No ____

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

Large accelerated filer __X__ Accelerated filer ____ Non-accelerated filer ____ Emerging growth company ____

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

Yes ____ No ____

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

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

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

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

Item 17 ____ Item 18 ____

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

Yes ____ No __X__

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

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

Portions of the Prudential's Annual Report 2017 incorporated by reference herein contain references to our website. Information on our website or any other website referenced in the Prudential Annual Report 2017 is not incorporated into this Form 20-F and should not be considered to be part of the Form 20-F. We have included any website as an inactive textual reference only.

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FORWARD-LOOKING STATEMENTS

This document may contain 'forward-looking statements' with respect to certain of Prudential's plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations and including, without limitation, statements containing the words 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', 'intends', 'expects', 'plans', 'seeks' and 'anticipates', and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore undue reliance should not be placed on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, the timing, costs and successful implementation of the demerger described herein; the future trading value of the shares of Prudential plc and the trading value and liquidity of the shares of the to-be-listed M&G Prudential business following such demerger; future market conditions, including fluctuations in interest rates and exchange rates, the potential for a sustained low-interest rate environment, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives; the political, legal and economic effects of the UK's decision to leave the European Union; the impact of continuing designation as a Global Systemically Important Insurer or 'G-SII'; the impact of competition, economic uncertainty, inflation and deflation; the effect on Prudential's business and results from, in particular, mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of internal projects and other strategic actions failing to meet their objectives; disruption to the availability, confidentiality or integrity of Prudential's IT systems (or those of its suppliers); the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal and regulatory actions, investigations and disputes. These and other important factors may, for example, result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. Further discussion of these and other important factors that could cause Prudential's actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential's forward-looking statements can be found under the 'Risk Factors' heading of this annual report, as well as under the 'Risk Factors' heading of any subsequent Prudential Half Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K.

Any forward-looking statements contained in this document speak only as of the date on which they are made. Prudential expressly disclaims any obligation to update any of the forward-looking statements contained in this document or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, the Hong Kong Listing Rules, the SGX-ST listing rules or other applicable laws and regulations. Prudential may also make or disclose written and/or oral forward-looking statements in reports filed with or furnished to the US Securities and Exchange Commission, the UK Prudential Regulation Authority and Financial Conduct Authority or other regulatory authorities, as well as in its annual report and accounts to shareholders, proxy statements, offering circulars, registration statements, prospectuses and, prospectus supplements, press releases and other written materials and in oral statements made by directors, officers or employees of Prudential to third parties, including financial analysts. All such forward-looking statements are qualified in their entirety by reference to the factors discussed under the 'Risk Factors' heading of this document, as well as under the 'Risk Factors' heading of any subsequent Prudential Half Year Financial Report furnished to the US Securities and Exchange Commission on Form 6-K.These factors are not exhaustive as Prudential operates in a continually changing business environment with new risks emerging from time to time that it may be unable to predict or that it currently does not expect to have a material adverse effect on its business.

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SUMMARY OF OUR BUSINESS

About Prudential

Prudential is an international financial services group serving over 26 million customers and with £669 billion of assets under management (as at 31 December 2017). Prudential plc is incorporated in England and Wales and is listed on stock exchanges in London, Hong Kong, Singapore and New York. It has been in existence for more than 169 years.

Prudential plc is the parent company of the Prudential group (the 'Prudential Group', 'Prudential' or the 'Group'). Prudential is not affiliated in any manner with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America, whose principal place of business is in the US.

Selected Historical Financial Information

The following table sets forth selected consolidated financial data for Prudential for the periods indicated. Certain data is derived from Prudential's audited consolidated financial statements prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU'). EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2017, there were no unendorsed standards effective for the years presented below which impacts the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, the selected consolidated financial data presented below that is derived from Prudential's audited consolidated financial statements is derived from audited consolidated financial statements prepared in accordance with IFRS as issued by the IASB. This table is only a summary and should be read in conjunction with Prudential's consolidated financial statements and the related notes included elsewhere in this document, together with the disclosures in the 'Financial Review' section.

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Income statement data

	Year ended 31 December					
	2017	**2017**	**2016**	**2015**	**2014**	**2013**
	$m(1)	**£m**	**£m**	**£m**	**£m**	**£m**
Gross premium earned	**59,534**	**44,005**	38,981	36,663	32,832	30,502
Outward reinsurance premiums	**(2,790)**	**(2,062)**	(2,020)	(1,157)	(799)	(658)
Earned premiums, net of reinsurance	**56,744**	**41,943**	36,961	35,506	32,033	29,844
Investment return	**57,077**	**42,189**	32,511	3,304	25,787	20,347
Other income	**3,288**	**2,430**	2,370	2,495	2,306	2,184
Total revenue, net of reinsurance	**117,109**	**86,562**	71,842	41,305	60,126	52,375
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(98,129)**	**(72,532)**	(59,366)	(29,656)	(50,169)	(43,154)
Acquisition costs and other expenditure	**(13,752)**	**(10,165)**	(8,848)	(8,208)	(6,752)	(6,861)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(575)**	**(425)**	(360)	(312)	(341)	(305)
Profit (loss) attaching to disposal of businesses	**309**	**228**	(238)	(46)	(13)	(120)
Total charges, net of reinsurance and profit (loss) attaching to disposal of businesses	**(112,147)**	**(82,894)**	(68,812)	(38,222)	(57,275)	(50,440)
Share of profits from joint ventures and associates, net of related tax	**409**	**302**	182	238	303	147
Profit before tax (*being tax attributable to shareholders' and policyholders' returns*)(2)	**5,371**	**3,970**	3,212	3,321	3,154	2,082
Tax charges attributable to policyholders' returns	**(912)**	**(674)**	(937)	(173)	(540)	(447)
Profit before tax attributable to shareholders	**4,459**	**3,296**	2,275	3,148	2,614	1,635
Tax credit (charge) attributable to shareholders' returns	**(1,226)**	**(906)**	(354)	(569)	(398)	(289)
Profit for the year	**3,233**	**2,390**	1,921	2,579	2,216	1,346

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	2017(1)	2017	2016	2015	2014	2013
	(In $m, except for Share Information)	£m, except for Share Information				
Statement of financial position data						
Total assets	**668,253**	**493,941**	470,498	386,985	369,204	325,932
Total policyholder liabilities and unallocated surplus of with-profits funds	**579,304**	**428,194**	403,313	335,614	321,989	286,014
Core structural borrowings of shareholder financed operations	**8,496**	**6,280**	6,798	5,011	4,304	4,636
Total liabilities	**646,479**	**477,847**	455,831	374,029	357,392	316,281
Total equity	**21,774**	**16,094**	14,667	12,956	11,812	9,651
Other data						
Based on profit for the year attributable to the equity holders of the Company:						
Basic earnings per share (in pence)	**126.0¢**	**93.1p**	75.0p	101.0p	86.9p	52.8p
Diluted earnings per share (in pence)	**125.8¢**	**93.0p**	75.0p	100.9p	86.8p	52.7p
Dividend per share declared and paid in reporting period (in pence)(5)						
Interim ordinary dividend/final ordinary dividend	**61.0¢**	**45.07p**	39.40p	38.05p	35.03p	30.52p
Equivalent cents per share(6)		**59.28¢**	55.21¢	59.11¢	58.44¢	50.58¢
Special dividend			10.00p			
Equivalent cents per share(6)			14.51¢			
Market price per share at end of period(7)	**2,578.0¢**	**1,905.5p**	1,627.5p	1,531.0p	1,492.0p	1,340.0p
Weighted average number of shares (in millions)		**2,567**	2,560	2,553	2,549	2,548
New business:						
Single premium sales(3)	**43,245**	**31,965**	27,841	27,687	24,296	22,665
New regular premium sales(3)(4)	**5,090**	**3,762**	3,536	2,697	2,107	2,043
Funds under management	**905,496**	**669,300**	602,300	508,600	496,000	443,000

(1)
Amounts stated in US dollars in the 2017 US dollar column have been translated from pounds sterling at the rate of $1.3529 per £1.00 (the noon buying rate in New York City on 29 December 2017).

(2)
This measure is the formal profit (loss) before tax measure under IFRS but is not the result attributable to shareholders. See 'Presentation of results before tax' in note A3.1(b) to Prudential's consolidated financial statements for further explanation.

(3)

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

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

(4)

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

(5)

Under IFRS, dividends declared or approved after the balance sheet date in respect of the prior reporting period are treated as a non-adjusting event. The appropriation reflected in the statement of changes in equity, therefore, includes dividend in respect of the prior year that was declared or approved after the balance sheet date of the prior reporting period. Parent company dividends relating to the reporting period were a first interim ordinary dividend of 14.50p per share in 2017 (2016: 12.93p, 2015: 12.31p), a second interim ordinary dividend of 32.50p per share in 2017 (2016: 30.57p, 2015: 26.47p) and a special dividend of 10.00p per share in 2015 only.

(6)

The dividends have been translated into US dollars at the noon buying rate in New York City on the date each payment was made.

(7)

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

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Summary Overview of Operating and Financial Review and Prospects

The following summary discussion and analysis should be read in conjunction with Prudential's consolidated financial statements and the related notes to Prudential's consolidated financial statements included in this document.

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

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

During 2017, our clear, consistent strategy, high-quality products and improving capabilities have enabled us to meet the needs of customers around the world better than ever before.

Our purpose is to help remove uncertainty from life's big events. Whether that's starting a family, saving for a child's education or planning for retirement, we provide our customers with financial peace of mind, enabling them to face the future with greater confidence. We also invest our customers' money actively in the real economy, helping not only to improve the lives of individuals and families, but also to build stronger communities and drive the cycle of growth.

Our strategy is aligned to structural trends: the savings and protection needs of the fast-growing middle class in Asia, the retirement income needs of the approximately 75 million baby boomers in the United States[1] and the growing demand for managed savings solutions among the ageing populations of the United Kingdom and Europe. These trends are sustained, and we remain focused on the opportunities they present.

We have continued to develop our products and our capabilities in order to improve the way we meet customers' needs. We are creating new, better and more personalised products, and we have a flexible, collaborative approach to incorporating the best digital technologies into our operations, while also leveraging our global scale to share new insights across our businesses at pace. The result is constant improvement in the way we serve our customers, providing value both to them and to our shareholders.

In March 2018 the Group announced its intention to demerge its UK and Europe businesses ('M&G Prudential') from Prudential plc, resulting in two separately-listed companies, with different investment characteristics and opportunities. Our businesses share common heritage, values and purpose. Looking forward, we believe we will be better able to focus on meeting our customers' rapidly evolving needs and to deliver long-term value to investors as two separate businesses. On completion of the demerger, shareholders will hold interests in both Prudential plc and M&G Prudential.

In line with its strategy to transition towards a more capital efficient, de-risked business model, M&G Prudential agreed in March 2018 to the sale of £12.0 billion[17] of its shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured £12.0 billion[17] of liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The capital benefit of this transaction will be retained within the Group to support the UK demerger process.

In preparation for the UK demerger process, and to align the ownership of the Group's businesses with their operating structures, Prudential plc intends to transfer the legal ownership of its Hong Kong insurance subsidiaries from The Prudential Assurance Company Limited (M&G Prudential's UK regulated insurance entity) to Prudential Corporation Asia Limited, which is expected to complete by the end of 2019.

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Currency volatility

As in previous years, we comment on our performance in local currency terms (expressed on a constant exchange rate, or CER basis) to show the underlying business trends in a period of currency movement. We have used this basis in discussions below for our Asian and US businesses to maintain comparability. Currency values in the countries in which we operate have fluctuated in the course of 2017.

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

The table below explains how the Group's profit after tax on an IFRS basis reconciles to profit before tax and the supplementary analysis of operating profit based on longer-term investment returns. Further explanation on the determination of operating profit based on longer-term investment returns is provided in the "Basis of Performance Measures" section. Further explanation on non-operating items is provided in the sub-section "non-operating items". The table presents the 2016 results on both an actual exchange rate and constant exchange rate basis so as to eliminate the impact of exchange translation. Actual Exchange Rates (AER) are actual historical exchange rates for the specific accounting period, being the average rates over the period for the income statement and the closing rates for the balance sheet at the balance sheet date. Constant Exchange Rates (CER) results are calculated by translating prior period results using the current period foreign exchange rate ie current period average rates for the income statement and current period closing rates for the balance sheet.

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IFRS Profit

	Actual Exchange Rate			Constant Exchange Rate		Actual Exchange Rate
	2017	2016*	Change	2016*	Change	2015*
	£m	£m	%	£m	%	£m
Profit after tax for the year attributable to shareholders	**2,390**	1,921	24%	1,982	21%	2,579
Tax charge attributable to shareholders' returns	**906**	354	156%	360	152%	569
Profit before tax attributable to shareholders	**3,296**	2,275	45%	2,342	41%	3,148
Non-operating items:						
Losses/(gains) from short-term fluctuations in investment returns	**1,563**	1,678	(7)%	1,764	(11)%	755
Amortisation of acquisition accounting adjustments	**63**	76	(17)%	79	(20)%	122
Profit (loss) attaching to disposal of businesses	**(223)**	227	(198)%	244	(191)%	(56)
	1,403	1,981	(29)%	2,087	(33)%	821
Operating profit before tax based on longer-term investment returns	**4,699**	4,256	10%	4,429	6%	3,969
Analysed into:						
Asia	**1,975**	1,644	20%	1,720	15%	1,286
US	**2,224**	2,048	9%	2,152	3%	1,702
UK and Europe	**1,378**	1,253	10%	1,253	10%	1,637
Other income and expenditure	**(878)**	(689)	27%	(696)	26%	(656)
Operating profit before tax based on longer-term investment returns	**4,699**	4,256	10%	4,429	6%	3,969

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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

Group performance

We have built on our good start to 2017 through disciplined execution of our strategy, again led by our businesses in Asia.

On 14 March 2018, we announced the achievement of our remaining 2017 objectives, which were set in December 2013. Our Asia businesses delivered growth in operating profit based on longer-term investment returns[2] at a compound average rate of 16 per cent[3] over the period 2012 to 2017. This is testament to the strength, scale and diversity of our Asia platform, validates our focus on recurring premium health and protection business and demonstrates the strength of our operational execution. It also marks the third set of objectives that we have successfully achieved within the last 10 years.

During 2017 we combined our UK and European life and asset management businesses to form M&G Prudential, which delivered record levels of external asset management net inflows of £17.3 billion in 2017. This contributed to combined assets under management[4] of £351 billion at 31 December 2017.

Profit for the year after tax for 2017 was £2,390 million compared with £1,921 million for 2016 on an AER basis. The increase primarily reflects the movement in profit before tax attributable to shareholders,

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which increased from a profit of £2,275 million in 2016 (on an AER basis) to a profit of £3,296 million in 2017, which was partially offset by an increase in the tax charge attributable to shareholders from £354 million in 2016 to £906 million in 2017. The increase in tax charge is primarily attributable to the impact of the US tax reform, which generated a one-off charge of £445 million.

On an actual exchange rate basis, the increase in the total profit before tax attributable to shareholders from £2,275 million in 2016 to £3,296 million in 2017 reflects an improvement in operating profit based on longer-term investment returns of £443 million or 10 per cent, which was further improved by a positive change in non-operating items of £578 million, from a loss of £1,981 million to a loss of £1,403 million. The positive change in non-operating items of £578 million is primarily attributable to the profit attaching to disposal of businesses of £162 million in 2017 compared with the loss of £227 million in 2016 and the favourable change in short-term fluctuations in investment returns of £115 million from negative £1,678 million in 2016 to negative £1,563 million in 2017. The improvement of £443 million in total operating profit based on longer term investment returns on an actual exchange rate basis reflects an increase in Asia (from £1,644 million to £1,975 million), the US (from £2,048 million to £2,224 million), the UK and Europe (from £1,253 million to £1,378 million), partially offset by an increase in loss from other income and expenditure (from a loss of £689 million to £878 million). The increase of £443 million or 10 per cent in the Group operating profit based on longer-term investments includes a positive exchange translation impact of £173 million. Excluding the effect of currency volatility, on a constant exchange rate basis, Group operating profit based on longer-term investment returns increased from £4,429 million to £4,699 million, 6 per cent higher than the equivalent amount in 2016.

Operating profit based on longer-term investment returns from our Asia life insurance and asset management businesses grew by 15 per cent[5], reflecting continued broad-based business momentum across the region, with double-digit[5] growth in eight out of 12 life insurance markets. In the US, Jackson's total operating profit based on longer-term investment returns increased by 3 per cent[5], due mainly to growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread earnings. In the UK and Europe, M&G Prudential's total operating profit based on longer-term investment returns was 10 per cent higher than the prior year, reflecting 6 per cent growth in operating profit generated from insurance business and 18 per cent growth in that generated from asset management.

The Group's capital generation is underpinned by our large and growing in-force business portfolio, and focus on profitable, short-payback business. Cash remittances to the Group increased to £1,788 million, with Asia the largest contributor[6] at £645 million. The Group's overall performance supported an 8 per cent increase in the 2017 full year ordinary dividend to 47 pence per share.

The Group remains robustly capitalised, with a 2017 year-end Solvency II cover ratio[7,8] of 202 per cent. Over the period, shareholders' funds increased by 10 per cent to £16.1 billion, reflecting profit after tax of £2,390 million (2016: £1,921 million on an actual exchange rate basis) net of other movements that included dividend payments to shareholders of £1,159 million and adverse foreign exchange movements of £470 million.

In Asia, we continue to develop our capabilities and reach, which build scale and enhance quality. Our asset management business, Eastspring Investments, has again seen growth, with its total assets under management up 18 per cent[9] to £138.9 billion and operating profit also up 18 per cent[5] £176 million.

In the US, we remain focused on meeting the retirement income needs of the growing generation of baby boomer retirees and expanding our operations into the large asset pools of the fee-based advisory market. Although the evolving regulatory environment continues to cause industry sales disruption, in 2017 Jackson delivered positive separate account net inflows of £3.5 billion, with separate account assets reaching £130.5 billion, an increase of 19 per cent[5]. In December 2017 the US enacted a major tax reform package, including a reduction in the corporate income tax rate from 35 per cent to 21 per

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cent effective from 1 January 2018. While this led to a £445 million charge in the income statement from re-measuring deferred tax balances on the IFRS balance sheet, we expect the tax changes to be positive in the long term. The US effective tax rate is expected to fall from the current rate of circa 28 per cent to circa 18 per cent in the future.

In the UK, both our UK life and asset management businesses performed well in 2017. PruFund new business sales increased significantly, while M&G saw record net inflows of £17.3 billion from external clients. Overall M&G Prudential assets under management[4] reached £351 billion, up from £311 billion at 31 December 2016.

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

A successful strategy

Our performance is based on our clear, consistent and successful strategy, which is focused on long-term opportunities arising from structural trends in our markets around the world.

In Asia, the growth of the middle class is creating significant and long-term demand for the products we offer. The working-age population in the region is growing by a million people a month, and by 2030 is expected to reach 2.5 billion[10], while 65 per cent of Asian private financial wealth is held in cash[11] and at the same time, that wealth is growing by US$4 trillion a year[11].

The growing and increasingly wealthy middle classes of the region are under-protected. In Asia, out-of-pocket healthcare spend makes up 42 per cent of total health expenditure[12], compared with just 12 per cent in the US and 9 per cent in the UK. While in a more developed market such as the UK insurance penetration is equivalent to 7.5 per cent[13] of GDP, in Asia that figure is just 2.4 per cent[13], giving an idea of the scale of the growth opportunity that remains in our Asian markets. The gap between the insurance cover of people in the region and what they need in order to maintain the living standards of their families has been estimated at circa £35 trillion[14]. We help to bridge that gap with a broad range of solutions across 14 markets in the region. We are in the top three in nine of our markets in Asia[15], and we have 15 million life customers, with access to total markets of more than 3.3 billion people.

The United States is the world's largest retirement market, with approximately 40 million Americans reaching retirement age over the next decade alone, and these consumers have a need for investment options through which they can grow their savings while at the same time protecting their income. This is creating demand for our variable annuity products, which are designed to help this cohort of Americans avoid running out of money and provide them with a reliable cushion against volatile markets. In the US, over US$15 trillion is invested in adviser-distributed financial assets net of existing annuities, while penetration of variable annuity sales into the retirement market remains low, demonstrating the scale of the opportunity for us.

In the UK and Europe there is growing demand among customers for managed solutions, savings products that provide better long-term returns than cash, while smoothing out the ups and downs of the market. We meet that need through our PruFund propositions and our comprehensive range of actively managed funds. M&G Prudential is well positioned to target this growing customer demand for comprehensive financial solutions and the demerger will enable this business to play an even greater role in these markets.

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Doing more for our customers

We deliver on our clear strategy and our long-term opportunities by paying close attention to the needs of our customers, by responding to those needs with products that fit their changing requirements, and by improving our capabilities continually in order to deliver the best products in the most effective way.

In Asia, our broad-based portfolio of businesses continues to drive the growth of the Group. We are constantly improving the range and quality of the products we offer in the region, developing our multi-channel distribution platform to ensure that those products reach as many customers as possible and improving our capabilities throughout our operations, not least by accessing new innovations in digital technology.

We develop products that meet the needs of our customers, whether that is for more personalised features or products aimed at new areas of the market and in 2017 we launched a number of new health and protection products in Indonesia, Vietnam, Singapore, Malaysia and Hong Kong. We are also continuing to improve both our agency platform and our bancassurance partnerships in Asia to ensure that we reach as many customers as possible. Nowhere is this clearer than in China, where, through our joint venture CITIC-Prudential, we now have a presence in 77 cities, with access to 940 million people, or about 70 per cent of the population of the world's most populous country. We have over 44,000 agents in China and access to more than 4,000 bank branches. Across the region during 2017 we increased our total agents to over 600,000 and we ended the year with over 15 million life insurance customers. Recent announcements of new agreements in the Philippines, Thailand, Indonesia and Vietnam have also increased the reach of our bancassurance partnerships.

Continuous improvement of our capabilities is also a key part of our approach, and in Asia we introduced a number of digital initiatives that will benefit both our customers and our shareholders, including apps and chatbots, that, among other services, can provide rapid claims payment, constant customer support, answer queries, help schedule appointments and transfer feedback from customers to our businesses. Building on its success in Hong Kong our myDNA service, which provides diet and exercise advice based on genetic profiles, has been launched in Vietnam, Malaysia and Singapore. In Singapore we also launched PRU Fintegrate, a new initiative enabling us to collaborate with fintech startups to co-develop digital solutions for customers.

Eastspring is well placed for the anticipated growth in Asia's retail mutual fund market. To prepare further, we have strengthened our in house investment teams, entered into new strategic partnerships and made significant progress in systems and operating model upgrades. In addition, Eastspring recognises that environmental, social and governance (ESG) factors can be material to investment returns particularly in the long term, and has become a signatory to the United Nations-supported Principles for Responsible Investment (PRI), joining M&G Prudential asset management.

In the United States, we are continuing to develop our business to ensure we capture the opportunity presented by the millions of Americans moving into retirement now and over the coming years. Regulatory and industry changes are creating new areas of growth potential and we are adapting our offering to meet those opportunities. During 2017, in response to evolving conditions in the hybrid adviser segment of the market, Jackson launched Perspective Advisory II, an advisory version of our flagship product, Perspective II. We also announced the formation in November of our Private Wealth & Trust group, a specialised team focused on complex planning, investment management and tax mitigation strategies for high-net-worth clients. At the same time, we are improving communication for customers, and our initiatives in this area last year included the launch of a new website, the Financial Freedom Studio, where consumers can learn about financial planning for retirement, aimed at simplifying the language and focusing on planning for lifetime income.

In the UK and Europe, the combination of our life and asset management businesses into M&G Prudential has enabled us to meet the needs of our customers better than ever before. The business manages £351 billion of assets[4] for more than seven million customers, both in the UK and

internationally, and we are leveraging our scale, financial strength and complementary product and distribution capabilities to enhance the development of capital-efficient customer-focused solutions. Bringing these businesses together has given us the opportunity to deliver better collaboration across business segments and more innovative and differentiated propositions. It also provides better access to customers and channels, merger cost synergies and transformation benefits, including the chance to invest to create a digital, data-led business with low marginal cost of growth. M&G Prudential is in the top five in UK retail funds[16], with an active management offering, and provides a range of consumer-focused retirement and savings wrappers. The performance of its products continues to make them very popular among customers. The flagship PruFund Growth Life Fund, for example, has grown by 36 per cent since the start of 2013, compared with benchmark growth of 30 per cent, and this performance has driven growth in PruFund assets under management from £7.5 billion in 2012 to £35.9 billion at the end of 2017. To improve the offering to customers, in 2017 the business rolled out myM&G, its direct-to-consumer platform.

We took another step forward in our Africa business in 2017 when we entered Nigeria, Africa's largest economy and our fifth market in the region. Following the launch of our businesses in Ghana, Kenya, Uganda and Zambia, this further demonstrates our commitment to Africa and our determination to bring the benefits of our products to customers across the region.

We continue to invest in our capabilities and our people across the organisation. In July we welcomed Mark FitzPatrick to our executive team as Chief Financial Officer, succeeding Nic Nicandrou, who took over from Tony Wilkey as Chief Executive of Prudential Corporation Asia. Mark brings with him significant experience and knowledge of the sector, and we are confident that Nic will lead our Asian business to further success. In March 2018, James Turner was appointed Group Chief Risk Officer, bringing fresh perspective and additional leadership capacity to our executive team.

A positive outlook

With our clear strategy focused on long-term trends around the world and continued improvements in our execution capabilities, we are delivering value to our customers, our shareholders and the communities in which we operate. This is supported by our ongoing focus on risk management and the strength of our balance sheet. We believe the demerger of M&G Prudential from the international group will leave both businesses better able to focus on meeting our customers' rapidly evolving needs and to deliver long-term value to investors as two separate companies. We have no doubt that the strength of our underlying opportunities and our proven ability to innovate and improve the way we do things will ensure that both businesses are well positioned to continue to serve our customers well and grow profitably into the future.

1. Source: US Census Bureau, Population Division, 2017 estimate of population.
2. Operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the consolidated financial statements.
3. The current year and all comparative amounts for the Asia objectives exclude contributions from the Korea life business which was sold in 2017. The 2017 Asia operating profit objective was adjusted accordingly. 2012 comparative amounts include the one-off gain on sale of stake in China Life of Taiwan of £51 million.
4. Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long term insurance business balance sheet.
5. Year-on-year percentage increased are stated on a constant exchange rate basis unless otherwise stated.
6. Based on the 2017 operating segments.
7. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.

8.
Estimated before allowing for second interim dividend.

9.
Growth rate on actual exchange rate basis.

10.
Working age population 15 64 years. Source: United Nations, Department of Economic and Social Affairs, Population Division (2015). World Population Prospects: The 2015 Revision, DVD Edition.

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11. Source: BCG Global Wealth 2016. Navigating the New Client Landscape
12. Source: World health Organisation Global Health Observatory data repository (2013). Out of pocket as percentage of total health expenditure.
13. Source: Swiss Re Sigma 2015. Insurance penetration calculated as premiums as percentage of GDP. Asia penetration calculated on a weighted population basis.
14. Source: Swiss Re, Mortality Protection Gap: Asia-Pacific, 2015.
15. Source: Based on formal (Competitors' results release, local regulators and insurance associations) and informal (industry exchange) market share data. Ranking based on new business (APE or weighted FYP depending on the availability of data).
16. Source: The Investment Association, September 2017.
17. Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.

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Group at a Glance

We meet the long-term savings and protection needs of a growing middle class and ageing population. We focus on three markets Asia, the US and UK and Europe where the need for our products is strong and growing and we use our capabilities, footprint and scale to meet that need. In recent years, we have expanded into Africa, taking advantage of the emerging demand for our products in the region.

We aim to capture three long-term opportunities across our key geographical markets:

serving the protection and investment needs of the growing middle class in Asia;

providing asset accumulation and retirement income products to US baby boomers; and

meeting the savings and retirement needs of an ageing British and continental European population.

We aim to generate attractive returns, enabling us to provide financial security to our customers, invest in growth opportunities and meet our customers' high expectations.

Total funds under management

Customers worldwide

Asia
Prudential Corporation Asia has leading insurance and asset management operations across 14 markets and serves the families of the region's high potential economies. We have been operating in Asia for over 90 years and have built high-performing businesses with multichannel distribution, a product portfolio centred on regular savings and protection, award-winning customer services and a widely recognised brand.

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

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

UK and Europe
In August we announced the formation of M&G Prudential, a leading savings and investments business, ideally positioned to target growing customer demand for financial solutions in the UK and Europe. Our vision is a business built for the customer: simple, efficient, digitally enabled, capital light, fast-growing and above all focused on delivery. The combined business benefits from two

strong complementary brands, a world-class investment capability, international distribution and a robust capital position.

Africa

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

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OUR BUSINESS SEGMENTS

Following the combination during the year of the Group's UK insurance business and M&G to form M&G Prudential the Prudential Group is restructured around three main business units: Prudential Corporation Asia (incorporating the asset management business, Eastspring Investments), North America Business Unit and M&G Prudential in UK and Europe. In addition, in recent years, the Group has expanded into Africa. These are supported by central functions which are responsible for Prudential strategy, cash and capital management, leadership development and succession, reputation management and other core group functions.

Asia

Introduction

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

As at 31 December 2017, Prudential Corporation Asia had:

- over 15 million life insurance customers with life and fund management operations in 14 markets;
- distribution through more than 12,000 active bank branches across Asia with relationships including Standard Chartered Bank (SCB), United Overseas Bank Limited (UOB), ICICI Bank in India, CITIC in China and Thanachart in Thailand;
- over 600,000 agents across the region;
- consistently high brand recognition and received multiple awards for its customer service; and
- a top 3 position in 9 out of the 12 life markets[1]

Life Insurance

Market overview

In Asia the insurance and savings industries are still in their infancy with average insurance penetration rates at just 2.4 per cent[2], well below those seen in the UK. 65 per cent of personal wealth in Asia is held in cash or deposits relative to 14 per cent in the US. There are significant growth opportunities that arise from simply addressing these existing concerns. However, there are key structural trends that will further increase this strong demand for savings and protection for decades ahead.

The first is the growing working population which is predicted to increase at over 1 million people per month. This means that between 2015 and 2030 some 178 million people will reach working age, roughly the equivalent to the combined populations of the UK, France and Italy.

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The second trend relates to the significant economic growth potential of the region with, GDP in Asia predicted to increase significantly. The implications on wealth creation are profound with private financial wealth increasing by some US$4 trillion per annum from 2016 to reach US$78 trillion by 2021.

The third trend covers the expanding mortality and morbidity protection gaps; as families' wealth increases so does the amount of money they need to sustain their lifestyles in the event of a life changing event such as the death of a breadwinner or the diagnosis of a critical illness. Research concluded that in Prudential's life markets, the mortality gap is US$45 trillion[3] and out of pocket healthcare expenditure is roughly four times the rates seen in the US and UK.

While these opportunities are attractive, there are a number of challenges associated with executing them. The industry is highly regulated as governments are rightly very concerned about ensuring individuals do not take undue risks with their savings and receive fair outcomes. The products are intangible with the benefits potentially not crystallising for many years; customers need to have a high level of confidence in the company that they are entrusting their financial well-being to. The products can be complex and unfamiliar so customers typically need advice and guidance on how to address their individual needs. Building, training and managing teams of financial advisers that can do this takes considerable time and expertise. Within this context, Prudential is differentiated by its long history in Asia, the breadth and depth of its operations, and its discipline and quality of execution.

Prudential Corporation Asia has all the key attributes for continuing success, starting with a footprint of life insurance and asset management business spanning 14 countries and giving us access to 3.3 billion people. We also have unrivalled expertise in the region, having been in Malaysia since 1924, and entering markets early such as India, China, Vietnam and most recently Cambodia and Laos. We also pioneered industry developments in the region, such as unit-linked products and bancassurance. Our sheer scale is a key competitive advantage with over 600,000 agents, access to more than 10,000 bank branches, 15 million life customers, 24 million life policies currently in-force and £139 billion of assets under management.

From this position of strength, we are now leveraging our expertise further to deliver greater value from our agency and bank channels, broaden our product offering and drive efficiencies in our operational platforms. We are also being increasingly innovative in the ways we add value for our customers, often harnessing digital technology.

Distribution

Prudential Corporation Asia has one of the strongest distribution platforms in the region, with a well-diversified mix of tied agents and bank partners that enables us to reach a broad range of customers. Our experience is that customers' fundamental preference for face-to-face advice and service from a trusted financial adviser is undiminished, and so tied agency and in-branch bank sales staff will remain our primary distribution channels.

However, we are making significant investments in upgrading our capabilities to ensure we not only meet but exceed our customers' expectations, including digital innovations and efficiencies, when they interact with our distributors. For example in Singapore our agents are now equipped with our fourth generation of an electronic point of sales ('ePos') portal that uses the latest developments in biometric authentication and produces a detailed quote within three minutes. In China our mobile policy application process has reduced customer on-boarding time from five days to 30 minutes and includes auto underwriting and verification so policies can be issued within seconds. These initiatives not only give our customers a better experience, but also help our agents become more productive; in China the number of active agents increased 24 per cent last year and with increased average case sizes.

Our agency management capabilities in terms of recruiting and training are well proven, but we are continuing to upgrade these. For example in Indonesia, where we recruited an average of over 4,500

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agents per month during 2017, our PRUforce agency workbench has enabled us to reduce significantly on-boarding times. 'Million Dollar Round Table' membership is an industry-recognised indicator of agency quality and in Hong Kong we lead the market with over 4,000 qualifiers up by 53 per cent[4]. We are also adapting technology to improve the service we provide to our agents, such as askPRU in Singapore, the industry's first chat bot policy enquiry system. Since its launch, calls to the service centre have reduced by 30 per cent.

We believe bancassurance is an effective way to increase insurance penetration and Prudential has an excellent track record in growing high quality business through this channel with a number of different partners. For example, we have had an enduring regional relationship with Standard Chartered Bank since 1998 and the ongoing effectiveness of this relationship is evidenced by increased sales last year. We have also had great success in securing and then activating newer relationships, for example Thanachart Bank in Thailand grew sales last year following collaboration on a new regular premium product.

In addition we are actively increasing our engagement with other banks. We have recently announced new agreements with Robinsons Bank in the Philippines, Siam Commercial Bank in Thailand for the provision of unit linked products to their high worth customers and Shinhan Bank in Indonesia and Vietnam.

Products

Prudential has a full suite of products that are tailored to meet individual market requirements and customer needs. Our overarching priority is to ensure firstly that customers have appropriate levels of protection and then support them with their long-term savings objectives. Consequently a relatively high proportion of our average premiums are directed to protection products, and regular premiums comprised the majority of the total sales. This mix is also beneficial to shareholders, as regular premiums provide a reliable stream of compounding revenues and protection business has higher profit margins as shareholders are providing capital to support risks.

While we are already one of the leaders in the protection space, continued innovation is essential for our ongoing success. In Hong Kong we recently launched a very popular upgrade to our critical illness product, PRUhealth critical illness multi-care, which provides lifetime multi-claim, lump-sum cover for 113 disease conditions, including three claims for cancer up to a total of 300 per cent of the sum assured.

We are also successfully evolving our product ranges within markets to cater for a more differentiated range of customer needs. For example, in Indonesia we have introduced Hebat, a lower premium investment linked product, at one end of the spectrum for emerging customers and an 'as charged' medical product at the other end for higher net worth customers. In Indonesia and Malaysia we have been successfully developing takaful products to provide for the specific needs of Muslim customers.

Work is also underway to ensure we have active dialogues with our customers so their products keep up with their changing needs. Technology is also helping here; during 2017 we piloted 'next best offer' with our agents in Hong Kong. This is an AI-driven app that automatically recommends additional coverage to existing customers.

New Business Premiums

In 2017, the total sales of insurance products were £6,006 million, up 1 per cent from 2016 (£5,948 million). Of this amount, regular premium insurance sales increased 6 per cent to £3,650 million and single premium insurance sales fell 6 per cent to £2,356 million.

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

	Actual Exchange Rate*		
Single premiums	**2017**	**2016**	**2015**
	£m	**£m**	**£m**
Hong Kong	**582**	1,140	546
Indonesia	**288**	236	230
Malaysia	**73**	110	100
Philippines	**62**	91	146
Singapore	**859**	523	454
Thailand	**139**	80	69
Vietnam	**8**	6	6
South East Asia operations including Hong Kong	**2,011**	2,186	1,551
China (Prudential's 50% interest in joint venture)	**179**	124	308
Taiwan	**46**	36	45
India (Prudential's 26% interest in associate)	**63**	51	34
Total Asia insurance operations excluding Korea	**2,299**	2,397	1,938
Korea**	**57**	98	182
Total Asia insurance operations including Korea	**2,356**	2,495	2,120

Regular premiums	**2017**	**2016**	**2015**
	£m	**£m**	**£m**
Cambodia	**16**	14	8
Hong Kong	**1,667**	1,798	1,158
Indonesia	**268**	255	303
Malaysia	**271**	233	201
Philippines	**71**	61	44
Singapore	**361**	299	264
Thailand	**70**	81	88
Vietnam	**133**	115	82
South East Asia operations including Hong Kong	**2,857**	2,856	2,148
China (Prudential's 50% interest in joint venture)	**276**	187	111
Taiwan	**208**	146	127
India (Prudential's 26% interest in associates)	**234**	170	132
Total Asia insurance operations excluding Korea	**3,575**	3,359	2,518
Korea**	**75**	94	123
Total Asia insurance operations including Korea	**3,650**	3,453	2,641

	2017	**2016**	**2015**
	£m	**£m**	**£m**
Total excluding Korea	**5,874**	5,756	4,456
Korea**	**132**	192	305

Total including Korea	**6,006**	5,948	4,761

*
Actual Exchange Rate (AER) for translating new business premiums are actual historical exchange rates for the specific accounting period, being the average rates over the accounting period shown.

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

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Customers

Excellent customer service is a prerequisite for sustained success in the industry and we are continuously driving improvements. For example, in China we have introduced WeChat e-claims that have reduced the processing time for a seven day hospitalisation claim from around 18 days to two days. The usage rate of e-claims is 99 per cent. In Hong Kong we have simplified the verification processes for Mainland China customers using iPads and GPS so they no longer need to visit our customer service centre. In Indonesia we have developed, PRUcheers, an analytics-driven business engine that performs a pre-assessment of claims so that low risk ones can now be turned around in minutes, and the turnaround time for medical claims has been reduced by 15 per cent.

However, in addition to improved processes, customers are increasingly looking for value added services that go beyond the basic product proposition and so provide opportunities for us to increase our connections with them. In Hong Kong we found that myDNA, a service that provides customised diet and exercise advice supported by an app and based on an individual's genetic profile, is very popular and so this has already been rolled out to Vietnam, Malaysia and Singapore. In Malaysia we have partnered with BP Global for their Doctor2U app. This gives our customers preferential rates on services that include online video medical consultations and the option to have a call-out 24/7. In Indonesia we have the PRUmedical network covering 45 hospitals in 24 cities. Our customers receive priority admission and discharge to reduce waiting times, and are also guaranteed rooms.

More broadly, we are also engaging with customers in areas that concern them. Our Relationship Index gives insights on one of the most important areas of customers' lives, their relationships with their loved ones. Customers are also increasingly concerned that companies they are associated with are 'good'. Our Prudence Foundation has well recognised community initiatives around children's education, including the Cha-Ching financial literacy programme and our disaster preparedness initiatives including the Safe-Steps campaigns on Natural Disasters, Road Safety and First Aid. Our YouTube channels that hold videos related to these and other initiatives have had over 100 million views.

Asset management

Eastspring Investments, Prudential's asset management business in Asia, manages investments for Prudential's Asia and UK life companies and also has a broad base of third-party retail and institutional clients.

Eastspring has a number of advantages and is well placed for the anticipated growth in Asia's retail mutual fund market. It has one of the largest footprints in Asia, being operational in 10 major markets. It has a well-diversified customer base, comprising Prudential's internal life funds, and a number of institutional clients, including sovereign wealth funds and retail customers. Assets managed are well diversified between fixed income and equities and also include infrastructure funds.

Recent developments include a broadening and strengthening of our in house investment teams with some key hires, winning the 'Best Asset Management House' award[5], new strategic partnerships (BlackRock, Sustainable Growth Advisers and Korea Advanced Institute of Science and Technology), significant progress with our systems and operating model upgrades and enhancing our institutional coverage by adding consultants in Asia and the US. We have also recently received approval of our business licence as an investment management wholly-foreign owned enterprise in China.

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

	At 31 December		
	2017	2016	2015
	£bn	£bn	£bn
Internal fund management	**83.0**	72.2	52.8
External fund management	**55.9**	45.7	36.3
Total	**138.9**	117.9	89.1

Investing for growth

Given the compelling opportunities we see in the region we will continue investing for growth. We will continue to enhance our core operations, expanding our traditional distribution reach with more, higher quality agents; we will add new bank distribution partners and explore adding some non- traditional ones too. We will accelerate the work in digitising and automating our processes and ensure we have enhanced abilities to connect with the broader cloud-based ecosystem.

We are already one of the leaders in the health space, but we will investigate opportunities to participate more broadly in this area with more comprehensive and flexible coverages and a wider range of value added services. We will position Eastspring to play a greater role in managing Asia's rising wealth and we will also expand our presence in China.

Underpinning our ability to build on our existing strengths and build out our capabilities is our priority to continue investing in our people. It is vital that we further enhance our diverse and highly talented workforce.

1. Prudential's rank in insurance market by new business. Based on formal (competitors results releases, local regulators, insurance associations) and informal (industry exchange) market share data.
2. Source: Swiss Re Sigma 2015. Insurance penetration calculated as premiums as percentage of GDP. Asia penetration calculated on a weighted population basis.
3. Swiss Re Mortality Protection Gap Report Asia Pacific 2015.
4. Annual growth to 1 July 2017. Source: The Premier Association of Financial Professionals.
5. 2018 Asia Asset Management 'Best of the Best Regional Awards' Best Asset Management House.

United States

Introduction

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

As at 31 December 2017, in the United States, Jackson:

was the 16th largest life insurance company in terms of general account assets[1];

had 19 per cent market share of US variable annuities[2] and had £130.5 billion of separate account assets; and

has been recognised for customer service performance with the "Contact Center World Class FCR Certification' and 'Highest Customer Service for the Financial Industry' awards by The Service Quality Measurement Group, Inc. for the 11th consecutive year.

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The US operations also include PPM Holdings, Inc. ('PPM'), Prudential's US internal and institutional investment management operation, and National Planning Holdings, Inc. ('NPH'), Prudential's US affiliated independent broker dealer network. During 2017, NPH sold the business of the four firms in its independent broker-dealer network to LPL Financial LLC ('LPL'). As at 31 December 2017, Prudential's US operations had more than 4 million policies and contracts in force and PPM managed approximately £82.2 billion of assets. In 2017, new business premiums totalled £16,622 million.

Market overview

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

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

To overcome these challenges, Americans need and demand retirement strategies that offer them the opportunity to grow and protect the value of their existing assets, as well as the ability to provide guaranteed income that will last throughout their extended lifetimes. Jackson continues to respond to this demand with product innovation and distribution strategies that meet the needs of a growing retirement population, while generating shareholder value.

Customers and products

Through its distribution partners, Jackson provides products, including variable, fixed and fixed index annuities, which offer Americans the retirement strategies they need. These products also offer tax deferral, which allows interest and earnings to grow tax-free until withdrawals are made.

Jackson has a proven track record in this market with its market-leading flagship product[2], Perspective II. Jackson's success has been built on its quick-to-market product innovation, as demonstrated by the development and launch of Elite Access in 2012, our investment-only variable annuity. Further demonstrating Jackson's flexibility and manufacturing capabilities, Jackson has launched Perspective Advisory II and Elite Access Advisory to serve advisers and distributors with a preference for advisory products. In November, Jackson launched Private Wealth Shield (PWS), a variable annuity developed specifically for trusts and private banks. To support this new product, Jackson also announced the formation of its Private Wealth & Trust group, a specialised team focused on complex planning, investment management and tax mitigation strategies for high-net-worth and ultra-high net-worth clients.

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Additional information on products

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

	Actual Exchange Rate Year Ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
By Product			
Annuities			
Fixed annuities			
Fixed interest rate	**434**	533	462
Fixed index	**295**	508	458
Immediate	**20**	22	15
Variable annuities	**11,536**	10,653	11,977
Elite Access (Variable annuities)	**2,013**	2,056	3,144
Total	**14,298**	13,772	16,056
Institutional products			
GICs, funding agreements and Federal Home Loan Bank of Indianapolis (FHLBI) funding agreements	**2,324**	1,836	1,230
Total	**16,622**	15,608	17,286
By Distribution Channel			
Independent broker dealer	**9,637**	8,809	10,145
Bank	**1,948**	2,137	2,730
Regional broker dealer	**2,228**	2,199	2,634
Independent insurance agents	**485**	627	547
Institutional products	**2,324**	1,836	1,230
Total	**16,622**	15,608	17,286

Of the total new business premiums of £16,622 million in 2017 (2016: £15,608 million; 2015: £17,286 million), £14,298 million (2016: £13,772 million; 2015: £16,056 million) were single premiums, and £2,324 million (2016: £1,836 million; 2015: £1,230 million) were institutional product premiums. There were no regular premiums.

Annuities

Fixed annuities

Fixed interest rate annuities

In 2017, fixed interest rate annuities accounted for 3 per cent (2016: 3 per cent) of total new business premiums and 7 per cent (2016: 8 per cent) of policy and contract liabilities of the US operations. Fixed interest rate annuities are primarily deferred annuity products that are used for asset accumulation in retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The contract holder of a fixed interest rate annuity pays Jackson a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and in some cases administrative charges are deducted from the contract holder's account. Jackson makes benefit payments at a future date as specified in the contract based on the value of the contract holder's

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account at that date. On more than 94 per cent (2016: 94 per cent) of in-force business, Jackson may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, Jackson either pays the contract holder the amount in the contract holder account or begins making payments to the contract holder in the form of an immediate annuity product.

At 31 December 2017, Jackson had fixed interest rate annuities totalling £12.6 billion (US$17.0 billion) (2016: £14.2 billion (US$17.6 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 5.5 per cent and a 2.93 per cent average guaranteed rate (2016: 1.0 per cent to 5.5 per cent and a 2.96 per cent average guaranteed rate).

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

Approximately 60 per cent (2016: 62 per cent) of the fixed interest rate annuities Jackson wrote in 2017 provide for a market value adjustment that could be positive or negative on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment. While the MVA feature minimizes the surrender risk associated with certain fixed interest rate annuities, Jackson still bears a portion of the surrender risk on policies without this feature, and the investment risk on all fixed interest rate annuities.

Fixed index annuities

Fixed index annuities accounted for 2 per cent (2016: 3 per cent) of total new business premiums in 2017 and 5 per cent (2016: 6 per cent) of Jackson's policy and contract liabilities. Fixed index annuities vary in structure, but generally are deferred annuities that enable the contract holder to obtain a portion of an equity-linked return (based on participation rates and caps) and provide a guaranteed minimum return. These guaranteed minimum rates are generally set at 1.0 per cent to 3.0 per cent on index funds. At 31 December 2017, Jackson had fixed index annuities allocated to index funds totalling £6.3 billion (US$8.6 billion) (2016: £7.3 billion (US$9.0 billion)) in account value with minimum guaranteed rates on index accounts ranging from 1.0 per cent to 3.0 per cent and a 1.77 per cent average guaranteed rate (2016: 1.0 per cent to 3.0 per cent and a 1.77 per cent average guaranteed rate). Jackson also offers fixed interest accounts on some fixed index annuity products. At 31 December 2017, fixed interest accounts on fixed index annuities totalled £2.5 billion (US$3.4 billion) (2016: £2.6 billion (US$3.2 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 2.58 per cent average guaranteed rate (2016: 1.0 per cent to 3.0 per cent and a 2.55 per cent average guaranteed rate).

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

Jackson hedges the equity return risk on fixed index products using offsetting equity exposure in the variable annuity product. The cost of these hedges is taken into account in setting the index

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participation rates or caps. Jackson bears the investment risk and a portion of the surrender risk on these products.

Variable annuities

In 2017, variable annuities accounted for 81 per cent (2016: 81 per cent) of total new business premiums and 77 per cent (2016: 74 per cent) of Jackson's policy and contract liabilities. Variable annuities are deferred annuities that have the same tax advantages and payout options as fixed interest rate and fixed index annuities. They are also used for asset accumulation in retirement planning and to provide income in retirement.

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

At 31 December 2017, Jackson had variable annuity funds in fixed accounts totalling £5.9 billion (US$8.0 billion) (2016: £7.3 billion (US$9.0 billion)) with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 1.68 per cent average guaranteed rate (2016: 1.0 per cent to 3.0 per cent and a 1.64 per cent average guaranteed rate).

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

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

Profits in the variable annuity book of business will continue to be subject to the impact of market movements on both sales and allocations to the variable accounts and the effects of the economic

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hedging programme. Hedging is conducted based on an economic approach so the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility. Further information on Jackson's hedging or derivative programme is provided in the 'Disciplined risk management' section below.

Aggregate distribution of account values

As described above, at 31 December 2017, Jackson had fixed annuities (fixed interest rate and fixed index) and variable annuities fixed options totalling £27.3 billion (2016: £31.4 billion) in account value with minimum guaranteed rates. The table below shows the distribution of these account values within the range of minimum guaranteed interest rates as at 31 December 2017 and 2016:

	Account value	
	2017	**2016**
	£m	**£m**
Minimum guaranteed interest rates annuities		
1.0%	**6,887**	7,765
> 1.0% 2.0%	**7,385**	8,718
> 2.0% 3.0%	**9,799**	11,249
> 3.0% 4.0%	**1,272**	1,456
> 4.0% 5.0%	**1,744**	1,954
> 5.0% 5.5%	**220**	247
Total	**27,307**	31,389

Life insurance

Background

Jackson discontinued new sales of life insurance products in 2012. The discontinued life insurance products accounted for 9 per cent (2016: 10 per cent) of Jackson's policy and contract liabilities in 2017. Life products include term life and interest sensitive life (universal life and variable universal life.) Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a type of life insurance policy that combines death benefit protection with the ability for the contract holder account to be invested in separate account funds. Jackson's life insurance book has delivered consistent profitability, driven primarily by positive mortality and persistency margins. For certain fixed universal life plans, additional provisions are held to reflect the existence of guarantees offered in the past that are no longer supported by earnings on the existing asset portfolio, or for situations where future mortality charges are not expected to be sufficient to provide for future mortality costs.

Aggregate distribution of account values

Excluding the business formerly of the REALIC operations acquired in 2012 that is subject to the retrocession treaties, at 31 December 2017, Jackson had interest-sensitive life business in force with total account value of £6.3 billion (US$8.5 billion) (2016: £7.1 billion (US$8.8 billion)), with minimum guaranteed interest rates ranging from 2.5 per cent to 6.0 per cent with a 4.67 per cent average guaranteed rate (2016: 2.5 per cent to 6.0 per cent with a 4.66 per cent average guaranteed rate). The

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table below shows the distribution of the interest-sensitive life business' account values within this range of minimum guaranteed interest rates as at 31 December 2017 and 2016:

	Account value	
	2017	**2016**
	£m	**£m**
Minimum guaranteed interest rates life insurance		
> 2.0% 3.0%	**221**	243
> 3.0% 4.0%	**2,341**	2,675
> 4.0% 5.0%	**2,059**	2,333
> 5.0% 6.0%	**1,651**	1,839
Total	**6,272**	7,090

Institutional products

Institutional products consist of traditional guaranteed investment contracts ('GICs'), funding agreements (including agreements issued in conjunction with Jackson's participation in the US Federal Home Loan Bank of Indianapolis ('FHLBI') programme) and Medium-Term Note funding agreements. In 2017, institutional products accounted for 14 per cent (2016: 12 per cent) of total new business premiums and 1 per cent (2016: 1 per cent) of Jackson's policy and contract liabilities. The GICs are marketed by Jackson's institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its programme. Jackson makes its profit on the spread between the yield on its investments and the interest rate credited to contract holders.

Traditional guaranteed investment contracts

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

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

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

Funding agreements

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

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 contract holder on seven to 90 days' notice, and thus qualify as cash equivalents for the clients' purposes. In 2017 and 2016, there were no funding agreements terminable by the contract holder with less than 90 days' notice.

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

Medium term note funding agreements

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

Distribution

Jackson distributes products in all 50 states of the US and in the District of Columbia. Operations in the state of New York are conducted through a New York subsidiary. Jackson markets its retail products primarily through advice based distribution channels, including independent agents, independent broker-dealer firms, regional broker-dealers, wirehouses, and banks. For variable annuity sales, Jackson is the leader in the independent broker-dealer, bank and wirehouse channels[4] and second in regional firms[4].

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

In August 2017, National Planning Holdings (NPH), an affiliate of Jackson, announced the sale of the business of the four firms in its independent broker-dealer network to LPL Financial LLC (LPL). With the US financial services industry experiencing a time of significant regulatory change and consolidation in the independent broker-dealer (IBD) sector, Jackson has determined its overall strategy did not include being a consolidator in the retail IBD space. Rather, our primary strategy is to focus on expanding Jackson's success as the leading manufacturer of retirement income products in the country.

Regional broker dealers and wirehouses

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

Jackson's RBD team supports more than 41,000 representatives in regional broker dealers and wirehouses.

Banks, credit unions and other financial institutions

Jackson's Institutional Marketing Group distributes annuity products through banks, credit unions and other financial institutions and through third party marketing organisations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and at 31 December 2017 had access to more than 32,000 financial institution representatives through existing relationships with banks and credit unions. Jackson has established distribution relationships with medium sized regional banks, which it believes are unlikely to develop their own insurance product capability.

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Independent broker dealers

Jackson's retail distribution has been managed by Prudential's independent broker dealer network, NPH, prior to the sale to LPL, as described above.

Institutional products department

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

PPM

PPM is Prudential's US institutional investment management operation, with its primary office in Chicago. PPM manages assets for Prudential's US, UK and Asian affiliates. PPM provides affiliated and unaffiliated institutional clients with investment services including managing assets for separate accounts, US mutual funds and similar foreign pooled investment vehicles, a collateralised loan obligation and private equity funds. PPM's strategy is focused on managing existing assets effectively, maximising the benefits derived from synergies with our international asset management affiliates, and leveraging investment management capabilities across the Group. Recently, PPM announced plans to expand its marketing and distribution capabilities in order to support a broader range of investors, particularly in the unaffiliated institutional space.

Regulatory landscape

The industry has continued to manage through an ever-changing regulatory landscape. In April 2016, the US Department of Labor (DoL) released a final version of its Fiduciary Duty Rule (Rules), which seeks to eliminate conflicts of interest in investment advice, in order to protect and encourage savings and investment for working Americans. The DoL implemented a partial applicability date of 9 June, 2017 where fiduciary advisers have an obligation to give advice that adheres to 'impartial conduct standards'. These impartial conduct standards require advisers to adhere to a best interest standard when making investment recommendations, charge no more than reasonable compensation for their services, and refrain from making misleading statements. In late November, the DoL announced an 18-month extension on the full applicability date from 1 January, 2018, to 1 July, 2019. The DoL intends to complete its review under the Presidential Memorandum, instructing the DoL to re-examine its fiduciary rule and decide whether to propose further changes, leaving the final form of the Rules unclear.

As a result of the DoL regulatory initiative and the uncertainties regarding the application and implementation of the Rules, the annuity industry saw continued pressure on sales in 2017. Sales in the variable annuity industry as of the third quarter of 2017 at US$70.9 billion[5] were down 11 per cent compared with the same period last year. Even with competitors recently offering fixed index annuities with benefits that resemble those of variable annuities, sales of fixed index annuities (US$42.9 billion)[5] along with fixed annuity products (US$38.9 billion)[5] were lower as of the third quarter of 2017 at 9 per cent and 13 per cent respectively, compared with the same period last year. Total annuity industry sales were down approximately 11 per cent[5] as of the third quarter of 2017.

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

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The US National Association of Insurance Commissioners (NAIC) is currently conducting an industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and enhancing risk management. Following an industry quantitative impact study (QIS), changes have been proposed to the current framework. These changes were presented to the December NAIC national meeting, and were exposed for comment by industry and interested parties until early March 2018. Jackson will continue to engage with the industry and the NAIC during the comment period.

On 22 December 2017, President Trump signed into law the Tax Cuts and Jobs Act making significant changes to America's tax code. In 2017, the lowering of the corporate tax rate resulted in a charge for the reduction of Jackson's deferred tax assets. In the future, the lower rate and the effect of other changes to the calculation of taxable income are expected to lead to higher after-tax earnings, return on equity and capital generation, all else being equal.

Investment for growth

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

Jackson has implemented changes necessary to meet the requirements of the sections of the fiduciary rules which are effective. Jackson has made and continues to consider changes to its product offerings, entered into new selling agreements with advisory providers, and is working with its distributors to support implementation of the Best Interest Contract Exemption or product changes to the extent those become necessary before July 2019.

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

Disciplined risk management

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

Jackson's hedging or derivative programme is used to manage interest rate risk associated with a broad range of products and equity market risk attaching to its equity-based products, as explained further in note C7.3 to the consolidated financial statements. Jackson is able to aggregate financial risks across the company, obtain a unified view of our risk positions, and actively manage net risks through an economically-based hedging programme. A key element of our core strategy is to protect the company from severe economic scenarios while maintaining adequate regulatory capital. We benefit from the fact that the competitive environment continues to favour companies with robust financial strength and a demonstrated track record of financial discipline, both key elements of our long-term strategy.

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

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

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

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

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

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

Lowering crediting rates helps to mitigate the effect of spread compression, but the spreads could still decline as Jackson is typically only entitled to reset the crediting rates at limited pre-established intervals and the re-setting is subject to the guaranteed minimum rates. As at 31 December 2017, approximately 87 per cent of Jackson's fixed annuities, variable annuity fixed account options and interest-sensitive life business account values correspond to crediting rates that are at the minimum guaranteed interest rates (2016: 86 per cent). Tabular disclosures are provided above on the distribution of the account values of these businesses within the range of their contractual minimum guaranteed interest rates. The tables demonstrate that approximately 72 per cent (2016: 73 per cent) of Jackson's combined fixed annuities, variable annuity fixed account options and interest sensitive life business account values of £24 billion (2016: £28 billion) have contractual minimum rates of 3 per cent or less.

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Jackson's expectation for future spreads is also an important component in the amortisation of deferred acquisition costs. Significantly lower spreads may cause it to accelerate amortisation, thereby reducing total IFRS profit in the affected reporting period. Low market interest rates could also reduce Jackson's return on investments that are held to support the company's capital. In addition, changes in interest rates will affect the net unrealised gain or loss position of Jackson's available-for-sale fixed income securities, which is reported as a component of other comprehensive income. Further information on the factors affecting the pricing of products and asset liability management of Jackson is provided below.

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

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

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

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

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

Factors affecting pricing of products and asset liability management

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

Jackson designs its interest sensitive products and conducts its investment operations to match closely the duration of the assets in its investment portfolio with the annuity, life, and guaranteed investment contract product obligations. Jackson seeks to achieve a target spread between what it earns on its

assets and what it pays on its liabilities by investing principally in fixed-rate securities. Jackson also enters into options and futures contracts to hedge equity related movements in its products.

Jackson segregates its investment portfolio for certain investment management purposes, and as part of its overall investment strategy, into four portfolios: life and fixed annuities without market value adjustment, fixed annuities with market value adjustment, fixed index annuities and institutional liabilities. The portfolios backing life and fixed annuities with and without market value adjustments and the fixed index annuities have similar characteristics and differ primarily in duration. The portfolio backing the institutional liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the institutional portfolio is managed to permit less interest rate sensitivity and has limited exposure to mortgage backed securities. At 31 December 2017, less than one per cent of the institutional portfolio was invested in residential mortgage backed securities.

The fixed-rate products may incorporate surrender charges, market value adjustments, two-tiered interest rate structures or other limitations relating to when policies can be surrendered for cash, in order to encourage persistency. As of 31 December 2017, 52 per cent of Jackson's fixed annuity reserves had surrender penalties or other withdrawal restrictions. Substantially all of the institutional portfolio had withdrawal restrictions or market value adjustment provisions.

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

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

Notes

1. Source: Third Quarter 2017 SNL Financial

2. ©2018 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. Morningstar www.AnnuityIntel.com. Total Sales by Contract 3Q YTD 2017. Jackson's Perspective II for base states ranks #1 and Elite Access for base states ranks #8 for Total VA Sales out of 991 VA contracts with reported sales to Morningstar's quarterly sales survey as of 3Q YTD 2017.

3. Independent research and Market Metrics, a Strategic Insight Business.

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5.

LIMRA/Secure Retirement Institute, US Individual Annuity Participants Report 3Q YTD 2017.

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United Kingdom and Europe

Introduction

In August 2017, we combined M&G, our international investment management business, with Prudential's UK and European life insurance business to form M&G Prudential. We also announced a major investment programme in the new combined business's infrastructure to improve customer service, accelerate product development and widen customer choice.

As at 31 December 2017, M&G Prudential had

- total funds under management[1] of £351 billion;
- over 7.2 million customers; and
- products registered in 24 jurisdictions around the world.

Market overview

M&G Prudential serves two of the world's largest savings and investments markets with asset pools in the UK and Europe of £7 trillion and €14 trillion respectively. Across the region, people increasingly need help to meet their long-term financing goals as responsibility for retirement savings passes from state and employer to the individual. They want easy access to savings and investment solutions, as well as guidance and advice from trusted providers. In addition, persistently low rates of return on bank cash deposits are fuelling demand for investment solutions, whether people are saving for retirement, building a lump sum or protecting their wealth from inflation.

Managing £351 billion of assets[1] for over seven million customers in the UK and internationally, M&G Prudential has investment expertise, scale and financial strength and two well-respected brands M&G Investments and Prudential UK. With the substantial investment we will be making over the next five years in transforming the business's operations, including building our digital distribution capability, M&G Prudential is well placed to meet the growing and evolving saving and investment needs of customers across intermediated, institutional and retail direct channels.

Customers

Whether we're helping an individual saver plan for their future with more confidence, or helping a big pension fund to meet its future commitments to pensioners, serving the long-term interests of our customers is key to the long-term performance of our business.

In the UK, we manage the savings of direct and intermediated customers through a range of mutual funds. We are also a leading provider of savings and retirement solutions to direct and advised UK customers with a 19 per cent market share in life and pensions retail investments as at end September 2017, including the popular and successful PruFund proposition in a number of different wrappers. We also have a large book of UK customers who own traditional insurance-based savings products. In continental Europe, where we have a leading position in cross-border fund distribution with £44 billion[2] in assets under management, customers in 17 countries are able to access our investment strategies. Finally, we manage the pension and other long-term savings of millions of people through our relationships with 794 institutional clients, including 70 per cent of the UK's 50 largest pension schemes.

We see significant opportunities for continued revenue growth in four of these customer segments, including from the synergies available from the combination of our investment management and savings and retirement solutions businesses. We also see an opportunity to offer customers in our existing book of traditional savings products a new set of propositions as their needs evolve.

The expertise of the business in delivering investment outcomes for all of our customers is demonstrated by the scale of our operations. In total, M&G Prudential fund managers invest over £187 billion of assets

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on behalf of Prudential policyholders, in addition to the £164 billion of assets for customers invested in M&G mutual funds and institutional strategies. This combined investment footprint bolsters our investment solution capabilities allowing us to build the business around our customers and use our experience and insights to meet their needs.

Our products

Our aim is to provide our customers with savings and investment solutions which meet their long-term financial needs and goals, in the structure which best suits them. Behind these solutions is a powerful investment engine: a highly skilled team of over 120 fund managers who put our customers' money to work by sourcing investment opportunities globally across a wide spectrum of asset classes, including equities, bonds, credit, real estate and cash across both private and public markets.

Of the total of £351 billion in assets under management[1] across our entire product range, approximately 60 per cent is now invested in multi-asset solutions and strategies, including the market leading £36 billion PruFund range and the strongly performing £12 billion Episode Allocation range. This expertise in asset allocation is a key part of our investment capability and has again driven substantial inflows over the last year, as customers across the UK and Europe have continued to seek the diversification and flexibility of a multi-asset solution.

Other products include a range of unit-linked and collective investments, and within our corporate pension portfolio we continue to facilitate a range of auto-enrolment services.

For our savings and retirement customers we offer the PruFund range, which invests in our with-profits fund, the largest in the UK. The with-profits fund aims to smooth some of the extreme ups and downs of short-term investment performance to provide a more stable return. It has performed well over the past five years: for example, customers in the PruFund Growth Fund have seen growth of 36 per cent since the start of 2013 against benchmark growth of 30 per cent.

For direct investors in the UK and intermediated customers in the UK and internationally, we offer a range of 75 open-ended funds. The range offers a broad choice of asset types, geographies and investment strategies to help achieve a diversified portfolio. Our funds generally aim to deliver a rising income stream, long-term capital growth or a mixture of both, and the vast majority are available in ISA or JISA wrappers to UK direct customers. Almost all of our funds are managed actively for the long term.

Our open-ended flexible global bond fund, the M&G Optimal Income Fund, performed strongly in 2017. Having achieved an average annualised return of over 7 per cent since its launch in 2006, Optimal Income has been one of the top performing bond funds across all sectors over the last decade. This return for its customers has been rewarded with net inflows of over £5 billion during 2017, bringing its assets under management to £23 billion.

This year we added our first open-ended infrastructure fund to our range, which aims to provide individual investors with both a growing income stream and long-term capital appreciation through exposure to the equity of global listed infrastructure companies. We also launched the M&G ESG Global High Yield Fund, a sister fund to our £1 billion Global High Yield Bond Fund. The new fund is aimed at meeting the needs of individual investors seeking higher yield.

During 2017, we also launched a further six M&G funds on our new Luxembourg-domiciled SICAV platform. As one of the most popular investment vehicles within Europe, the ability to offer SICAV funds will enable us to expand and deepen our highly successful international business further over the coming years. The new platform will also ensure we can continue to serve our European-based customers regardless of the outcome of Brexit negotiations between the UK and the EU. To that end, in September we announced our plans to migrate assets in four UK-domiciled funds held by European customers to the SICAV platform during 2018.

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For our own life funds as well as for our third-party institutional clients, we continue to deliver innovative and competitive investment strategies to meet their specific needs. We are leading investors in 'alternative' assets such as commercial real estate debt, infrastructure debt and equity, and direct lending. These private assets are increasingly attractive options for investors looking for a yield to match their long-term pension liabilities, and of course also provide a valuable source of competitively-priced funding for new housing and infrastructure projects.

Reflecting growing demand from institutional clients for investments which make a positive societal and environmental impact, in 2017 we seeded our first Impact Financing Fund with investment from the Prudential life business and two third-party investors. Through private and illiquid debt transactions, the fund is already financing projects including a regeneration scheme, green energy and social housing construction.

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

Distribution

In M&G and Prudential, we have two well-respected and complementary brands: Prudential is closely associated with retirement in the UK, while M&G is recognised as a leading investment brand, both in the UK and across international markets. While our two brands occupy different market segments, both share a common philosophy of aiming to deliver excellent long-term customer outcomes, and both offer solutions powered by a world-class investment capability. Working together as M&G Prudential gives us new opportunities for growth by building on these shared values and strengths.

In the UK, where both M&G and Prudential products are distributed, we will be building on the great success of the PruFund range by broadening the existing proposition, making full use of M&G and Prudential's combined distribution network and making our customers' experiences whether direct or advised as good as possible throughout the lifetime of their products. Our digital transformation programme is essential to this, providing the infrastructure necessary to offer good value, state of the art solutions.

With over 15 years of experience in international distribution, offices in 18 countries and a new Luxembourg investment platform, we are well placed to continue to take advantage of the attractive growth opportunities in Europe and beyond. This includes retail distribution in Europe, and in international institutional markets, where our strong track record in private asset origination is a real competitive advantage.

Investment for growth

In a world of low interest rates and increasing life expectancy, more people than ever need long-term savings and investment solutions. We also know that our customers have far higher expectations of service and value for money, thanks to new technology and digital disruption. Over the last 169 years we have had a proud track record of innovating to deliver good outcomes to our customers, but we need to invest in our business to continue to do so. Over the next five years, we will be investing circa £250 million of shareholders' funds in our business, including a new digital infrastructure which will improve customer service, accelerate product development and increase customer choice. Strategic partnerships, such as the recently announced Tata Consultancy Services partnership to enhance service for our UK savings and retirement customers, are an important part of these plans to improve customer outcomes. With a simpler, more efficient, digitally enabled business, we will respond quicker and better to our customers' needs, offer better value and compete at scale in our markets even more effectively.

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Additional information on the long-term products of M&G Prudential

Long-term products

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

	Year Ended 31 December		
	2017	2016	2015
	£m	£m	£m
Individual annuities	**223**	546	565
Bonds	**3,509**	3,834	3,327
Corporate Pensions	**233**	231	310
Individual Pensions	**5,779**	2,567	1,217
Income drawdown	**2,218**	1,649	1,024
Other products	**1,269**	1,186	691
Wholesale			1,508
Total new business premiums	**13,231**	10,013	8,642

Of the total new business premiums of £13,231 million (2016: £10,013 million; 2015: £8,642 million), £13,044 million (2016: £9,836 million; 2015: £8,463 million) were for single premiums and £187 million (2016: £177 million; 2015: £179 million) were for regular premiums.

Pension annuities

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

M&G Prudential offers conventional annuities which include level (non-increasing), fixed increase and RPI annuities. In 2017, new business premiums for these conventional annuities were £223 million (2016: £495 million).

Bonds

Onshore Bonds

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

PIP also gives financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In 2017, new business premiums from the unit-linked option within on-shore bond wrappers, including PIP were £186 million (2016: £165 million).

M&G Prudential offers a unitised and smoothed with-profits investment fund called PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer with a

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choice of Cautious, Growth or Risk-Managed funds. PruFund also offers clients an optional guarantee on the initial investment in either the Cautious or Growth funds with terms between ten and fifteen years. PruFund is available across M&G Prudential's range of tax wrappers including individual pensions, income drawdown, ISA and onshore and offshore bonds. In 2017, total bonds new business premiums attributable to PruFund, including new business through PIP, was £2,342 million (2016: £2,608 million).

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

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

In addition M&G Prudential offers an open architecture onshore bond, the Prudential Onshore Portfolio Bond, which allows customers to access a wide range of quoted UK investments. New business premiums from this product were £80 million in 2017 (2016: £78 million). The new business premiums for other onshore bonds were £52 million in 2017 (2016: £106 million).

Offshore Bonds

M&G Prudential's offshore bond products are the Prudential International Investment Bond and the Prudential International Investment Portfolio offering clients access to a wide range of quoted UK investments. M&G Prudential's offshore bond sales fell by 3 per cent to £849 million in 2017 (2016: £877 million).

Pension and flexi-income drawdown products

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

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

Income drawdown products have historically provided a 'bridge' between pensions and annuities, allowing customers to access pension savings from age 55, subject to certain limits. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth. Income drawdown has proved popular with customers seeking greater flexibility than that offered by a traditional annuity product, but preferring to draw funds gradually rather than withdrawing all of their savings as cash. Depending on the size of their pension pot and the individual's tax position, it may also be more tax efficient for a customer to invest in a

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drawdown product rather than to take cash. Many of the pension products M&G Prudential offers are with-profits products or offer the option to have all or part of the contributions allocated to the with-profits fund. Where funds invested in the with-profits fund are withdrawn prior to the pension date specified by the policyholder, M&G Prudential may apply a market value adjustment (MVA) to the amount paid out. MVAs do not apply to the PruFund investment options. The remaining pension products are non-participating products, which include unit-linked products.

Individual Pensions and Income Drawdown

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

M&G Prudential launched its new Retirement Account proposition, which offers one account for both pension savings and income drawdown and can accept transfers from existing plans, to the intermediated market, including its own advised sales force, PFP, towards the end of the third quarter of 2016. It is a digital proposition with an open charging structure separating charges out for the tax wrapper, funds and guarantees and offers improved service to advisers and customers. The proposition has been well received in the market, securing significant sales since launch and accounting for 82% of total individual pension and income drawdown sales in 2017.

For products with drawdown features, the investment risk and mortality risk remains with the policyholder, payments are not guaranteed, and tend to cost more to administer. In the past, this has meant that the option to draw down income tended to apply mainly to more sophisticated policyholders commonly with larger retirement funds. The changes in the rules governing access to pension savings mean that consumers now have more choice and flexibility in how they access their retirement income and drawdown has become more popular for customers starting to take income in retirement. Any income taken from pension savings in excess of the allowable tax-free lump sum is taxable at a customer's marginal tax rate. Many more customers than before are taking their tax free cash and leaving their funds invested. To further extend the proposition and to continue to meet customers' needs for secure income whilst still retaining some flexibility, a minimum income guarantee is offered as an additional option.

Corporate Pensions

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

Other products

Other products include PruFund ISA, life insurance and equity release mortgages, which have been closed to new business since November 2009.

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

In common with other UK long-term insurance companies, M&G Prudential's products are structured as either with-profits products or non-participating (including unit-linked) products. With-profits policies are

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supported by a with-profits fund. M&G Prudential's primary with-profits fund is part of PAC's long-term fund. For statutory and management purposes, PAC's long-term fund consists of a number of sub-funds in which shareholders and policyholders have varying interests.

With-profits products

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

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

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

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

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

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

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

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

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

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

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

In 2017, PAC declared a total surplus of £2,385 million (2016: £2,198 million) from PAC's primary with-profits sub-fund, of which £2,152 million (2016: £1,983 million) was added to with-profits policies and £233 million net of tax (2016: £215 million) was distributed to shareholders of which 15 per cent was from PruFund business (2016:10 per cent). These amounts included annual bonus rates of 1.75 per cent until 28 February 2017 and 1.5 per cent for the remainder of the year for Prudence Bond; and 1.75 per cent until 31 March 2017 followed by 1.5 per cent for the remainder of the year for personal pensions.

The closed Scottish Amicable Insurance Fund ('SAIF') declared total bonuses in 2017 of £354 million compared with £349 million in 2016. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business.

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

Surplus Assets in PAC's With-profits Fund

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

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

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

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

Matters relating to with-profits sub-funds:

Pension mis-selling review The UK insurance regulator required all UK life insurance companies to review sales of personal pensions policies for potential mis-selling. Offers to all cases were made by 30 June 2002. Costs arising from this review are met by the excess assets of the PAC with-profits sub-fund and hence have not been charged to the asset shares used in the determination of policyholder bonus rates. Prudential has given an assurance that these deductions from excess assets will not impact its bonus or investment policy for policies within the with-profits sub-funds that were in force at 31 December 2003. This assurance does not apply to new business since 1 January 2004. In the unlikely event that such deductions would affect the bonus or investment policy for the relevant policies, Prudential has stated it would make available support to the sub-fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged.

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

In addition, certain pensions products within this sub-fund have guaranteed annuity rates at retirement, for which a provision of £503 million was held within the sub-fund (2016: £571 million).

Guaranteed annuities A provision for guaranteed annuity products of £53 million was held (2016: £62 million) in the PAC with-profits sub-fund.

Intra-group capital support arrangements

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

In addition, Prudential has put in place intra-group arrangements to formalise undertakings by Prudential to the regulators of the Hong Kong subsidiaries regarding their solvency levels.

Non-participating business

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

Notes

1. Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
2. Europe includes AUM in Asia and South Africa.

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Competition

General

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

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

- price and yields offered,
- financial strength and ratings,
- commission levels, charges and other expenses,
- range of product lines and product quality,
- brand strength, including reputation, quality of service and use of technological advances,
- distribution channels,
- investment management performance and
- historical bonus/contract enhancement and bonus interest levels.

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

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

Asia

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

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

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United States

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

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

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

United Kingdom

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

Sources

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

FINANCIAL REVIEW

IFRS Critical Accounting Policies

Prudential's discussion and analysis of its financial condition and results of operations are based upon Prudential's consolidated financial statements, which have been prepared in accordance with IFRS as issued by the IASB and as endorsed by the EU. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. As at 31 December 2017, there were no unendorsed standards effective for the three years ended 31 December 2017 affecting the consolidated financial information of Prudential and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the three years ended 31 December 2017 has been prepared in accordance with IFRS as issued by the IASB. Prudential adopts mandatory requirements of new or altered EU-adopted IFRS standards when required, and may consider earlier adoption where permitted and appropriate in the circumstances.

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

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially give rise to different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to the policies referenced below which are described further in the notes to the consolidated financial statements.

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

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

In determining the measurement of the Group's assets and liabilities and in preparing financial statements, more generally, estimates and judgements are required. Our critical accounts estimates and

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assumptions are those set out below, with a reference to the detailed discussion in the notes to our consolidated financial statements.

Critical accounting estimates and assumptions	Reference to the disclosure notes in the consolidated financial statements
Classification of insurance and investment contracts	A3.1(a)
Measurement of policyholder liabilities and unallocated surplus of with-profits	A3.1(a); and C4.2
Deferred acquisition costs for insurance contracts	A3.1(c); and C4.2
Financial investments Valuation	A3.1(c)
Financial investments Determining impairment in relation to financial assets	A3.1(c)
Additional quantitative information on the impairment and realised gains/losses recognised on the available-for-sale debt securities of US insurance operations	B1.2
Additional quantitative information on the movement in the statement of financial position value of the available-for-sale debt securities of US insurance operations and those which are in a gross unrealised loss position.	C3.2(b), C3.2(c)
Intangible assets Carrying value of distribution rights	A3.1(c)

Summary Consolidated Results and Basis of Preparation of Analysis

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

	Actual Exchange Rate Year Ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Total revenue, net of reinsurance	**86,562**	71,842	41,305
Total charges, net of reinsurance and profit (loss) attaching to disposal of businesses	**(82,894)**	(68,812)	(38,222)
Share of profits from joint ventures and associates, net of related tax	**302**	182	238
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)**	**3,970**	3,212	3,321
Tax attributable to policyholders' returns	**(674)**	(937)	(173)
Profit before tax attributable to shareholders	**3,296**	2,275	3,148
Tax charge	**(1,580)**	(1,291)	(742)
Less: tax attributable to policyholders' returns	**674**	937	173
Tax charge attributable to shareholders' returns	**(906)**	(354)	(569)
Profit for the year	**2,390**	1,921	2,579

*

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

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deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the PAC with-profits fund after adjusting for taxes borne by policyholders) is not representative of pre-tax profits attributable to shareholders. See 'Presentation of results before tax' under IFRS Critical Accounting Policies section above for further explanation.

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

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

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

(a) Group overview

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

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

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

Profit for the year after tax for 2016 was £1,921 million compared with £2,579 million for 2015. The decrease primarily reflected the movement in profit before tax attributable to shareholders, which

decreased from a profit of £3,148 million in 2015 to a profit of £2,275 million in 2016, which was partially offset by a decrease in the tax charge attributable to shareholders from £569 million in 2015 to £354 million in 2016.

The decrease in the total profit before tax attributable to shareholders from £3,148 million in 2015 to £2,275 million in 2016 reflected an improvement in operating profit based on longer-term investment returns of £287 million from £3,969 million in 2015 to £4,256 million in 2016 which was more than offset by an adverse change in non-operating items of £1,160 million, from negative £821 million to negative £1,981 million. The increase of £287 million or 7 per cent in operating profit based on longer-term investments included a positive exchange translation impact of £364 million. Excluding the effect of currency volatility, on a constant exchange rate basis, the Group operating profit based on longer-term investment returns decreased by £77 million or 2 per cent to £4,256 million with increases in Asia and the US offset by the expected decline in the contribution from our UK businesses.

The charge for non-operating items from 2015 to 2016 increased by £1,160 million primarily due to the adverse change in short-term fluctuations in investment returns from negative £755 million in 2015 to negative £1,678 million in 2016 and the inclusion in 2016 of a loss attaching to the held for sale Korea life business of £227 million.

The effective rate of tax at the total profit level was 16 per cent in 2016 compared with 18 per cent in 2015. The decreased rate principally reflected a smaller overall contribution to the total profit from US operations which attracted a higher rate of tax than other operations. Further details are provided in note B4 of the consolidated financial statements.

(b) Summary by business segment and geographical region

The Group's operating segments for financial reporting are defined and presented in accordance with IFRS 8, "Operating Segments," on the basis of the management reporting structure and its financial management information. Following the combination during the year of the Group's UK insurance business and M&G to form M&G Prudential, the Group has reassessed its operating segments.

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

In the prior year, the operating segments of the Group were each of the insurance operations in Asia, US and UK, and the asset management operations of Asia, US, M&G and Prudential Capital.

Operations which do not form part of any business unit are reported as 'Unallocated to a segment'. These include Group Head Office and Asia Regional Head Office costs. Following the formation of M&G Prudential certain minor operations which were previously reported as 'Unallocated to a segment' are now included in the UK and Europe segment, reflecting the revised structure. Prudential Capital and Africa operations do not form part of any operating segment under the revised structure, and their assets and liabilities and loss before tax are not material to the overall financial position of the Group. Prudential Capital and Africa operations are therefore reported as 'Unallocated to a segment'.

Comparative segmental information for prior periods has been presented on a basis consistent with the current year.

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

	Year Ended 31 December		
	2017	2016*	2015*
	£m	£m	£m
Asia	**1,775**	928	972
US	**254**	591	970
UK and Europe	**1,097**	1,184	1,229
Total profit attributable to the segment	**3,126**	2,703	3,171
Unallocated to a segment**	**(736)**	(782)	(592)
Total profit for the year	**2,390**	1,921	2,579

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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

In order to understand how Prudential's results are derived it is necessary to understand how profit emerges from its business. This varies from region to region, primarily due to differences in the nature of the products and regulatory environments in which Prudential operates. The 2016 and 2015 comparatives have been re-presented from those previously published in the tables below following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

Asia

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

	Year Ended 31 December		
	2017	2016	2015
	£m	£m	£m
Insurance operations	**1,852**	1,043	1,036
Asset management	**176**	141	115
Profit before shareholder tax	**2,028**	1,184	1,151
Shareholder tax charge	**(253)**	(256)	(179)
Profit after tax	**1,775**	928	972

The increase of £847 million from the profit after tax from £928 million in 2016 to £1,775 million in 2017 primarily reflects an increase in the profit before shareholder tax of £844 million from £1,184 million to £2,028 million. The shareholder tax charge remained consistent at £253 million in 2017 compared with £256 million in 2016.

The increase of £844 million in profit before tax attributable to shareholders includes an increase of £809 million in insurance operations from £1,043 million to £1,852 million and an increase of £35 million in asset management operations from £141 million to £176 million.

For the Asia insurance operations, the assets and liabilities of contracts classified as insurance under IFRS 4 are determined in accordance with methods prescribed by local GAAP and adjusted to comply, where necessary, with grandfathered UK GAAP. Under IFRS 4, subject to the conditions of that standard, the continued application of grandfathered UK GAAP in this respect is permitted. In some

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operations ie Taiwan and India, US GAAP principles are applied. For with-profits business in Hong Kong, Singapore and Malaysia, the basis of profit recognition is bonus driven as described under 'UK and Europe' below.

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

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

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

Profit after tax decreased from £972 million in 2015 to £928 million in 2016. The decrease of £44 million was attributable to an increase of £77 million in the shareholder tax charge from £179 million in 2015 to £256 million in 2016, partly offset by a favourable change of £33 million in profit before shareholder tax from £1,151 million in 2015 to £1,184 million in 2016.

The increase of £33 million in profit before tax attributable to shareholders included an increase of £7 million in insurance operations from £1,036 million to £1,043 million and an increase of £26 million in asset management operations from £115 million to £141 million.

The marginal increase of £7 million in insurance operations from £1,036 million in 2015 to a profit of £1,043 million in 2016 primarily reflected an increase of operating profit based on longer-term investment return of £332 million, which was partially offset by an increase in non-operating loss of £325 million. The increase of £332 million in operating profit based on longer-term investments included a positive exchange translation impact of £132 million. Excluding the currency volatility, Asia insurance operations operating profit based on longer-term investment returns was up 15 per cent on a constant exchange basis driven by the increase in the contribution from in-force business and reflecting the recurring premium income bias of our in-force book and the highly diverse nature of our earnings by geography and by product. The change of £325 million from a non-operating loss of £135 million in 2015 to a non-operating loss of £460 million in 2016 was primarily due to a £227 million loss attaching to the held for sale Korea life business in 2016 and the negative change of £88 million in short-term fluctuations in investment returns from £137 million in 2015 to £225 million in 2016. The negative change in short-term fluctuations in investment returns principally reflects the net impact of changes in interest rates and equity markets across the region.

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The increase of £26 million in asset management operations in 2016 compared with 2015 is primarily attributable to the positive effect on average asset under management of favourable market movements and £2.2 billion net inflows in the second half of the year.

The effective shareholder tax rate on profits from Asia operations increased to 22 per cent in 2016 compared with 16 per cent in 2015, with the movement principally due to the non-tax deductible write down of the Korea life business in 2016 following the agreement to sell the business.

United States

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

	Year Ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Insurance operations	**590**	529	1,199
Asset management*	**172**	(4)	11
Profit before shareholder tax	**762**	525	1,210
Shareholder tax charge	**(508)**	66	(240)
Profit after tax	**254**	591	970

* Includes the broker-dealer business up to its disposal in 2017.

The decrease of £337 million in profit after tax from £591 million in 2016 to £254 million in 2017 primarily reflects an increase in the shareholder tax charge by £574 million from a credit of £66 million in 2016 to a charge of £508 million in 2017. This was partly offset by an increase of £237 million in profit before shareholder tax from £525 million in 2016 to £762 million in 2017.

The increase in tax charge in 2017 is primarily attributable to the impact of the US tax reform, which generated a one-off charge of £445 million. The effective tax rate on profits from US operations was 67 per cent in 2017 compared with negative 13 per cent in 2016 is primarily driven by this one-off impact. Further details on the US tax reform are provided in note B4 to the consolidated financial statements.

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

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

The £61 million increase in insurance operations in 2017 compared with 2016, is primarily due to an increase of £162 million in operating profit based on longer-term investment returns from £2,052 million in 2016 to £2,214 million in 2017, partially offset by an increase in non-operating loss of £101 million. The increase of £162 million in operating profit based on longer-term investment returns includes a positive translation impact of £104 million. Excluding the currency volatility, the increase in operating profit based on longer-term investment return in 2017 on a constant exchange rate basis compared with

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2016 was £58 million or 3 per cent reflecting mainly growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread earnings.

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

The £176 million increase in asset management operations in 2017 compared with 2016 is primarily due to the gain of £162 million arising from the disposal of the Group's US broker-dealer network in August 2017. Further details are provided in note D1 to the consolidated financial statements.

Profit after tax decreased from £970 million in 2015 to £591 million in 2016. The decrease of £379 million was attributable to a decrease of £685 million in profit before shareholder tax from £1,210 million in 2015 to £525 million in 2016, partly offset by a favourable change in the shareholder tax charge from a charge of £240 million in 2015 to a credit of 66 million in 2016.

The decrease of £685 million in profit before tax attributable to shareholders from 2015 to 2016 included a decrease of £670 million in insurance operations from £1,199 million to £529 million and a decrease of £15 million in asset management operations from positive £11 million to negative £4 million.

The £670 million decrease in insurance operations in 2016 against 2015, was primarily due to an increase of £1,031 million in non-operating loss to £1,523 million, which was partially offset by an increase in operating profit based on longer-term investment returns from £1,691 million in 2015 to £2,052 million in 2016.The increase of £361 million in operating profit based on longer term investment returns included a positive translation impact of £217 million. Excluding the currency volatility, the increase in operating profit based on longer-term investment return in 2016 on a constant exchange rate basis compared with 2015 was £144 million or 8 per cent primarily as a result of higher fee income from growth in Jackson's separate account asset base and lower amortisation of deferred acquisition costs, which together exceeded the anticipated reduction in spread income. The non-operating loss increased by £1,031 million from a £492 million loss in 2015 to a loss of £1,523 million in 2016. The increase in non-operating loss was mainly driven by an adverse change in short term fluctuations in investment returns of £1,031 million from a loss of £424 million in 2015 to a loss of £1,455 million in 2016. The negative movement in short-term fluctuations in investment returns mainly reflects the net value movement on the guarantees offered by Jackson and the associated derivatives held to manage market exposures, as described further in the "Short-term fluctuations in investment returns" section below.

The profit before tax attributable to shareholders from asset management operations decreased by £15 million from a profit of £11 million in 2015 to a loss of £4 million in 2016.

The effective tax rate on profits from US operations was negative 13 per cent in 2016 compared with 20 per cent in 2015 principally driven by a higher negative short-term fluctuations in investment returns, which attracted tax relief at a higher rate than operating profit based on longer-term investment returns in the US operations.

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UK and Europe

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

	Year Ended 31 December		
	2017	2016*	2015*
	£m	£m	£m
Insurance operations	**858**	1,026	1,075
Asset management*	**506**	433	441
Profit before shareholder tax	**1,364**	1,459	1,516
Shareholder tax charge	**(267)**	(275)	(287)
Profit after tax	**1,097**	1,184	1,229

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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

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

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

For with-profits business (including non-participating business owned by the PAC with-profits fund), adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on the annual declaration of bonuses, shareholder profit for with-profits business is unaffected. This is because IFRS basis profits for the with-profits business, which are determined on the same basis as on grandfathered UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year. Further details on the determination of the bonuses ('regular' and 'final') are provided in note C4.2(c) to the consolidated financial statements.

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

The decrease in insurance operations of £168 million to £858 million in 2017 was driven by an adverse change in short-term fluctuations in investment returns on shareholder-backed operations from a profit of £198 million in 2016 to a loss of £20 million in 2017. This was partially offset by an increase in operating profit based on longer-term investment returns of £50 million. The £218 million decrease in short-term fluctuations in investment returns includes unrealised movements on fixed income assets supporting the capital of the shareholder-backed annuity business that vary differently depending on interest rate and other movements in the profit. Operating profits based on longer-term investments increased by £50 million from £828 million in 2016 to £878 million in 2017, with contributions from the

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core[1] with-profits and in-force annuity business stable at £597 million (2016: £601 million). Operating profit based on longer-term investment returns included general insurance commission of £17 million in 2017 compared with £29 million in 2016.

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

The effective shareholder tax rate on profits from UK and Europe operations increased to 20 per cent in 2017 from 19 per cent in 2016 principally due to a decrease in the proportion of income received which is not subject to tax.

Profit after tax from UK and Europe operations of £1,184 million in 2016 was £45 million lower than the £1,229 million in 2015. This was attributable to a decrease in profit before shareholder tax of £57 million from £1,516 million to £1,459 million combined with a decrease in the shareholder tax charge of £12 million from £287 million to £275 million.

The decrease of £57 million in profit before tax attributable to shareholders included a decrease of £49 million in insurance operations from £1,075 million to £1,026 million and a decrease of £8 million in asset management operations from £441 million to £433 million.

The decrease in insurance operations of £49 million from 2015 to £1,026 million in 2016 was driven by a decrease of £367 million in operating profit based on longer-term investments return, which was partially offset by a favourable movement in the short-term fluctuations in investment returns for shareholder-backed business of £318 million from £120 million loss in 2015 to £198 million gain in 2016. The £367 million, or 31 per cent, decrease in operating profit based on longer-term investment return reflects lower profit from new annuity business, down from £123 million to £41 million in 2016 as we scale down our participation in the annuity market, a lower contribution from management actions to support solvency, down from £400 million to £332 million, and the establishment of a £175 million provision in 2016 for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress. Operating profit based on longer term investment returns included general insurance commissions of £29 million in 2016 compared with £28 million for 2015. The favourable short term fluctuations in investment returns of £198 million reflects gains on bonds backing annuity capital and shareholders' funds following the 70bps fall in 15-year UK gilt yields in 2016.

The decrease in asset management operations of £8 million from £441 million in 2015 to £433 million in 2016 reflects the impact on revenues of lower average assets under management during the year, following the net outflows experienced since the second quarter of 2015.

The effective shareholder tax rate on profits from UK and Europe operations for 2016 remained at 19 per cent consistent with 2015.

Unallocated to a segment

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

	Year Ended 31 December		
	2017	**2016***	**2015***
	£m	**£m**	**£m**
Loss before shareholder tax	**(858)**	(893)	(729)
Shareholder tax credit	**122**	111	137
Loss after tax	**(736)**	(782)	(592)

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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Total net charges for activity unallocated to a segment decreased by £49 million from £782 million in 2016 to £736 million in 2017.

The loss before shareholder tax decreased by £35 million from £893 million in 2016 to £858 million in 2017. Other income and expenditure and restructuring costs increased by £189 million from £689 million in 2016 to £878 million in 2017 due to higher interest costs following the debt issued in 2016 and 2017, and higher restructuring costs, as the business invests for the future (including UK and Europe infrastructure). Short-term fluctuations in investment returns showed a favourable movement of £224 million from a loss of £204 million in 2016 to a profit of £20 million in 2017, reflecting the level of unrealised value movements on financial instruments that are dependent on market movements over the relevant reporting period.

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

Total net charges for unallocated to a segment activity increased by £190 million from £592 million in 2015 to £782 million in 2016.

The loss before shareholder tax increased by £164 million from £729 million in 2015 to £893 million in 2016. Other income and expenditure and restructuring and Solvency II implementation costs increased by £33 million from £656 million in 2015 to £689 million in 2016. Short-term fluctuations in investment returns increased by £131 million from a loss of £73 million in 2015 to a loss of £204 million in 2016, reflecting unrealised value movements on financial instruments.

The effective tax rate on profits from unallocated to a segment decreased to 12 per cent in 2016 from 19 per cent in 2015 principally due to an increase in non-tax deductible expenses decreasing the tax credit on the unallocated to a segment losses.

Notes

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

Basis of Performance Measures

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

The Group's operating segments for financial reporting are defined and presented in accordance with IFRS 8, 'Operating Segments' on the basis of the management reporting structure and its financial management information. Following the combination during the year of the Group's UK insurance business and M&G to form M&G Prudential. The Group has reassessed its operating segments.

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

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In the prior year, the operating segments of the Group were each of the insurance operations in Asia, US and UK, and the asset management operations of Asia, US, M&G and Prudential Capital.

Operations which do not form part of any business unit are reported as 'Unallocated to a segment'. These include Group Head Office and Asia Regional Head Office costs. Following the formation of M&G Prudential certain minor operations which were previously reported as 'Unallocated to a segment' are now included in the UK and Europe segment, reflecting the revised structure. Prudential Capital and Africa operations do not form part of any operating segment under the revised structure, and their assets and liabilities and loss before tax are not material to the overall financial position of the Group. Prudential Capital and Africa operations are therefore reported as 'Unallocated to a segment'.

Comparative segmental information for prior periods has been presented on a basis consistent with the current year.

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

- Short-term fluctuations in investment returns on shareholder-backed business. This includes the impact of short-term market effects on the carrying value of Jackson's guarantee liabilities and related derivatives as explained below.

- Amortisation of acquisition accounting adjustments arising on the purchase of business. This comprises principally the charge for the adjustments arising on the purchase of REALIC in 2012; and

- Profit / loss attaching to businesses that have been sold in the year including, where relevant, the recycling of the cumulative translation gain or loss in respect of sold businesses.

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

(a) General principles

(i) UK style with-profits business

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

(ii) Unit-linked business

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

(iii) US variable annuity and fixed index annuity business

This business has guarantee liabilities which are measured on a combination of fair value and other US GAAP derived principles. These liabilities are subject to an extensive derivative programme to manage equity and interest rate exposures. The principles for determination of the operating profit and short-term fluctuations are necessarily bespoke, as discussed in section (c) below.

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

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

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

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

(v) Other shareholder-financed business

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

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

Debt securities and loans

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

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

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

At 31 December 2017, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £855 million (2016: £969 million; 2015: £567 million).

Equity-type securities

For equity-type securities, the longer-term rates of return are estimates of the long-term trend investment returns for income and capital having regard to past performance, current trends and future expectations. Equity-type securities held for shareholder-financed operations other than the UK annuity

business, unit-linked and US variable annuity separate accounts are principally relevant for the US and Asia insurance operations. Different rates apply to different categories of equity-type securities.

Derivative value movements

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

(b) Asia insurance operations

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

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

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

(ii) Other Asia shareholder-financed business

Debt securities

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

Equity-type securities

For Asia insurance operations, investments in equity securities held for non-linked shareholder-backed operations amounted to £1,759 million as at 31 December 2017 (2016: £1,405 million; 2015: £840 million). The rates of return applied in 2017 ranged from 4.3 per cent to 17.2 per cent (2016: 3.2 per cent to 13.9 per cent; 2015: 3.5 per cent to 13.0 per cent) with the rates applied varying by business unit. These rates are broadly stable from period to period but may be different between countries reflecting, for example, differing expectations of inflation in each business unit. The assumptions are for the returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

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

(c) US insurance operations

(i) Separate account business

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

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(ii) US variable and fixed index annuity business

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

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

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

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

Embedded derivatives for variable annuity guarantee minimum income benefit

The GMIB liability, which is substantially fully reinsured, subject to a deductible and annual claim limits, is accounted for in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 944-80 Financial Services Insurance Separate Accounts (formerly SOP 03-1) under IFRS using 'grandfathered' US GAAP. This accounting basis substantially does not recognise the effects of market movements. As the corresponding reinsurance asset is net settled, it is considered to be a derivative under IAS 39, 'Financial Instruments: Recognition and Measurement', and the asset is therefore recognised at fair value. As the GMIB is economically reinsured, the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

(iii) Other derivative value movements

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

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(iv) Other US shareholder-financed business

Debt securities

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

Equity-type securities

As at 31 December 2017, the equity-type securities for US insurance non-separate account operations amounted to £946 million (2016: £1,323 million; 2015: £1,004 million). For these operations, the longer-term rates of return for income and capital applied in the years indicated, which reflect the combination of the average risk-free rates over the year and appropriate risk premiums are as follows:

	2017	**2016**	**2015**
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	**6.1% to 6.5%**	5.5% to 6.5%	5.7% to 6.4%
Other equity-type securities such as investments in limited partnerships and private equity funds	**8.1% to 8.5%**	7.5% to 8.5%	7.7% to 8.4%

(d) UK and Europe insurance operations

(i) Shareholder-backed annuity business

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

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

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

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Positive or negative experience compared with assumptions is included within short-term fluctuations in investment returns without further adjustment. The effects of other changes to

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credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

(ii) Non-linked shareholder-financed business

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

(e) Fund management and other non-insurance businesses

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

Analysis of operating profit based on longer-term investment returns

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

	2017					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
	£m	£m	£m	£m	£m	£m
Analysis of operating profit						
Operating profit (loss) based on longer-term investment returns	1,975	2,224	1,378	5,577	(878)	4,699
Short-term fluctuations in investment returns on shareholder-backed business	(1)	(1,568)	(14)	(1,583)	20	(1,563)
Amortisation of acquisition accounting adjustments	(7)	(56)		(63)		(63)
Profit attaching to the disposal of businesses		162		162		162
Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income	61			61		61
Profit (loss) before tax	2,028	762	1,364	4,154	(858)	3,296
Tax attributable to shareholders						(906)
Profit for the year						2,390

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	2016+ £m (AER)					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Analysis of operating profit						
Operating profit (loss) based on longer-term investment returns	1,644	2,048	1,253	4,945	(689)	4,256
Short-term fluctuations in investment returns on shareholder-backed business	(225)	(1,455)	206	(1,474)	(204)	(1,678)
Amortisation of acquisition accounting adjustments	(8)	(68)		(76)		(76)
Loss attaching to the held for sale Korea life business	(227)			(227)		(227)
Profit (loss) before tax	1,184	525	1,459	3,168	(893)	2,275
Tax attributable to shareholders						(354)
Profit for the year						1,921

	2016+,** £m (CER)					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Analysis of operating profit						
Operating profit (loss) based on longer-term investment return	1,720	2,152	1,253	5,125	(696)	4,429
Short-term fluctuations in investment returns on shareholder-backed business	(237)	(1,529)	206	(1,560)	(204)	(1,764)
Amortisation of acquisition accounting adjustments	(8)	(71)		(79)		(79)
Profit attaching to the held for sale Korea life business	(244)			(244)		(244)
Profit (loss) before tax	1,231	552	1,459	3,242	(900)	2,342
Tax attributable to shareholders						(360)
Profit for the year						1,982

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	2015+ £m (AER)					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Analysis of operating profit						
Operating profit (loss) based on longer-term investment returns	1,286	1,702	1,637	4,625	(656)	3,969
Short-term fluctuations in investment returns on shareholder-backed business	(137)	(424)	(121)	(682)	(73)	(755)
Amortisation of acquisition accounting adjustments	(8)	(68)		(76)		(76)
Profit attaching to the held for sale Korea life business	56			56		56
Cumulative exchange loss on sold Japan life business	(46)			(46)		(46)
Profit (loss) before tax	1,151	1,210	1,516	3,877	(729)	3,148
Tax attributable to shareholders						(569)
Profit for the year						2,579

	2015+,*** £m (CER)					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (other operations)	Group total
Analysis of operating profit						
Operating profit (loss) based on longer-term investment return	1,431	1,921	1,637	4,989	(656)	4,333
Short-term fluctuations in investment returns on shareholder-backed business	(154)	(479)	(121)	(754)	(73)	(827)
Amortisation of acquisition accounting adjustments	(9)	(76)		(85)		(85)
Profit attaching to the held for sale Korea life business	62			62		62
Cumulative exchange loss on sold Japan life business	(46)			(46)		(46)
Profit (loss) before tax	1,284	1,366	1,516	4,166	(729)	3,437
Tax attributable to shareholders						(621)
Profit for the year						2,816

+

The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements

**

For 2016, the CER results were calculated using the 2017 average exchange rates.

***

For 2015, the CER results were calculated using the 2016 average exchange rates.

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Explanation of Performance and Other Financial Measures

	Actual Exchange Rate 2017	Actual Exchange Rate 2016+	Change	Constant Exchange Rate*,+ 2016	Change	Actual Exchange Rate+ 2015	Constant Exchange Rate**,+ 2015
	£m	£m	%	£m	%	£m	£m
Asia							
Insurance operationsnote(ii)	**1,799**	1,503	20%	1,571	15%	1,171	1,303
Asset management	**176**	141	25%	149	18%	115	128
Total Asia	**1,975**	1,644	20%	1,720	15%	1,286	1,431
US							
Jackson (US insurance operations)note(ii)	**2,214**	2,052	8%	2,156	3%	1,691	1,908
Asset management	**10**	(4)	350%	(4)	350%	11	13
Total US	**2,224**	2,048	9%	2,152	3%	1,702	1,921
UK and Europe							
UK and Europe insurance operations:							
Long-term businessnote(ii)	**861**	799	8%	799	8%	1,167	1,167
General insurance commission	**17**	29	(41)%	29	(41)%	28	28
Total UK and Europe insurance operations	**878**	828	6%	828	6%	1,195	1,195
UK and Europe asset management	**500**	425	18%	425	18%	442	442
Total UK and Europe	**1,378**	1,253	10%	1,253	10%	1,637	1,637
Total segment profit	**5,577**	4,945	13%	5,125	9%	4,625	4,989
Other income and expenditure(1)	**(878)**	(689)	27%	(696)	26%	(656)	(656)
Operating profit based on longer-term investment returns before taxnote(i)	**4,699**	4,256	10%	4,429	6%	3,969	4,333
Non-operating items:							
Short-term fluctuations in investment returns on shareholder-backed businessnote(iii)	**(1,563)**	(1,678)	(7)%	(1,764)	(11)%	(755)	(827)
Amortisation of acquisition accounting adjustments	**(63)**	(76)	(17)%	(79)	(20)%	(76)	(85)
Profit (loss) attaching to disposal of businesses	**162**	(227)	n/a	(244)	n/a	56	62
Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income	**61**		n/a		n/a		

Cumulative exchange loss on the sold Japan life business recycled from other comprehensive income			n/a		n/a	(46)	(46)
Profit before tax attributable to shareholders	**3,296**	2,275	45%	2,342	41%	3,148	3,437
Tax charge attributable to shareholders' returns	**(906)**	(354)	(156)%	(360)	(152)%	(569)	(621)
Profit for the year attributable to shareholders	**2,390**	1,921	24%	1,982	21%	2,579	2,816

*
For 2016, the CER results were calculated using the 2017 average exchange rates.

**
For 2015, the CER results were calculated using the 2016 average exchange rates.

+
The 2016 and 2015 comparative results have been re-presented from those published previously, following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

Notes

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

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(ii)

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

(iii)

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

	Actual exchange rate		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Asia	**(1)**	(225)	(137)
US	**(1,568)**	(1,455)	(424)
UK and Europe*	**(14)**	206	(121)
Other operations*	**20**	(204)	(73)
Total	**(1,563)**	(1,678)	(755)

* The 2016 and 2015 comparative results have been re-presented from those published previously, following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

Further details on the short-term fluctuations in investment returns are provided below under 'Short-term fluctuations in investment returns' and also in note B1.2 in the consolidated financial statements.

Earnings per share

	Actual exchange rate			Constant exchange rate		Actual exchange rate
	2017	**2016**	**Change**	**2016**	**Change**	**2015**
	pence	**pence**	**%**	**pence**	**%**	**pence**
Basic earnings per share based on operating profit after tax	**145.2**	131.3	11	136.8	6	124.6
Basic earnings per share based on total profit after tax	**93.1**	75.0	24	77.4	20	101.0

Prudential's financial performance in 2017 has resulted in all of our 2017 financial objectives being met. Our progress across our KPIs reflects the benefits of our focus on driving growth in high-quality, recurring health and protection and fee business across our geographies, products and distribution channels.

Performance was broad-based across our business units, led by our Asia businesses which delivered double digit growth in operating profit based on longer-term investment returns[3] (up 15 per cent). Asia achieved its 2017 financial objectives, demonstrating successful execution of its strategy, focusing on diversified recurring premium business, at scale. In the US, we saw good growth in fee income, driven by positive net inflows and favourable equity market conditions, which outweighed the expected reduction in the contribution from spread income.

During 2017 we combined M&G and our UK and Europe life business to form M&G Prudential. M&G Prudential asset management delivered record external net inflows of £17.3 billion, with overall assets under management[2] at a new high of £351 billion at the end of 2017. We are making good progress in delivering our merger and transformation programme, and remain on track to deliver our previously announced savings

by the end of 2022.

Sterling continued to strengthen against most of the currencies in our major international markets over 2017. However, on an average basis, sterling exchange rates remain lower than 2016, contributing to a positive effect on the translation of results from our non-sterling operations in 2017. If sterling exchange rates remain at or above end 2017 levels over the remainder of 2018, this will act to depress our results on translation of our non-sterling operations in 2018 compared with 2017. To aid comparison of

underlying progress, we continue to express and comment on the performance trends in our Asia and US operations on a constant currency basis.

Our performance in 2017 was also supported by favourable equity markets, which lifted average investment balances on which we earn fees. During the year the S&P 500 index increased 19 per cent, the FTSE 100 index 8 per cent and the MSCI Asia excluding Japan index 39 per cent. Long-term yields showed little movement in 2017 and therefore have had no material impact on 2017 performance versus 2016.

The key financial highlights in 2017 were as follows:

- Asset management net inflows reached record levels, with M&G Prudential asset management reporting external net inflows of £17.3 billion (2016: net outflows of £8.1 billion) reflecting growth across its wholesale/direct and institutional businesses, and Eastspring delivering external net inflows of £3.1 billion (excluding money market funds) (2016: £1.8 billion on an actual exchange rate basis).

- Operating profit based on longer-term investment returns[3] was 6 per cent higher at £4,699 million (10 per cent higher on an actual exchange rate basis). Operating profit from our Asia business grew by 15 per cent to £1,975 million, reflecting continued business momentum. In the US, operating profit increased by 3 per cent, reflecting mainly growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread earnings. In the UK, M&G Prudential's total operating profit was 10 per cent higher than the prior year reflecting 6 per cent growth in the insurance business, with core[4] life operating profit stable at £597 million, and record asset management profit of £500 million resulting from the positive impact on earnings of net fund inflows, supportive markets and higher performance fees.

- Total IFRS post tax profit was up 21 per cent at £2,390 million (24 per cent on an actual exchange rate basis). Total profit includes the impact of short-term fluctuations in financial assets held to back the commitments that we have made to our customers, and the related liabilities, and are reported outside the operating result which is based on longer-term investment return assumptions. In 2017 these principally arose within Jackson as discussed later in the report. Total profit after tax includes the impact of the US tax reform, which generated a charge of £445 million from the re-measurement of US net deferred tax balances following the reduction in the corporate income tax rate. Reflecting this post-tax profit, Group IFRS shareholders' equity was 10 per cent higher at £16.1 billion.

- Group shareholders' Solvency II capital surplus[5] was estimated at £13.3 billion at 31 December 2017, equivalent to a cover ratio of 202 per cent[6] (1 January 2017: £12.5 billion, 201 per cent). The improvement in the period reflects the continuing strength of the Group's operating capital generation in excess of growing dividend payments to shareholders.

- Full year ordinary dividend increased by 8 per cent to 47 pence per share, reflecting our 2017 performance and our confidence in the future prospects of our Group.

Operating profit based on longer-term investment returns

2017 total operating profit increased by 6 per cent (10 per cent on an actual exchange rate basis) to £4,699 million, with increased contributions from all of our core business units.

2017 compared with 2016 (CER)

Asia total operating profit of £1,975 million was 15 per cent higher than the previous year (20 per cent on an actual exchange rate basis). Operating profit from life insurance operations increased 15 per cent to £1,799 million (20 per cent on an actual exchange rate basis), reflecting the continued growth of our in-force book of recurring premium business, with renewal insurance premiums[7] reaching £11.6 billion (2016: £9.5 billion on a constant exchange rate basis). Insurance margin was up 21 per cent, reflecting

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our continued focus on health and protection business. At a country level, we have seen improvement in all of our markets, with double-digit growth in operating profit based on longer-term investment return in eight out of 12, led by Hong Kong and China (both increasing 38 per cent). Including money market funds and the assets managed for internal life operations, Eastspring's total assets under management increased to £138.9 billion (2016: £117.9 billion on an actual exchange rate basis), while the cost-income ratio was stable at 56 per cent (2016: 56 per cent), driving an 18 per cent increase in operating profit to £176 million (2016: £149 million).

US total operating profit at £2,224 million increased by 3 per cent (9 per cent increase on an actual exchange rate basis), reflecting increased profit from our variable annuity business. US equity markets have continued to rise in 2017, which together with separate account net asset inflows of £3.5 billion, has led to separate account balances that were on average 17 per cent higher than the prior period. As a result, fee income increased 15 per cent to £2,343 million. Spread-based income decreased 10 per cent, as anticipated, reflecting the impact of lower yields on our fixed annuity portfolio and a reduced contribution from asset duration swaps. We expect these effects to continue to compress spread margins, although continued upwards movements in US yields may help to reduce the speed of the decline.

UK and Europe total operating profit was 10 per cent[3] higher at £1,378 million. Life insurance operating profit increased by 8 per cent to £861 million (2016: £799 million). Within this total, the contribution from our core[4] with-profits and in-force annuity business was £597 million (2016: £601 million), including an increased transfer to shareholders from the with-profits funds of £288 million (2016: £269 million) of which 15 per cent was from PruFund business (2016: 10 per cent). The balance of the life insurance result reflects the contribution from other activities which are not expected to recur to the same extent going forward. This includes, as anticipated, lower operating profit from the sale of annuities of £9 million (2016: £41 million) and a number of other items discussed below. Asset management operating profit increased 18 per cent to £500 million, driven by higher average assets under management and improved performance fees, together with a lower cost-income ratio of 58 per cent (2016: 59 per cent).

We took a number of actions during the year to optimise our asset portfolios and capital position, which generated profit of £276 million (2016: £332 million). Of this amount £31 million related to profit from longevity risk transactions (2016: £197 million) and £245 million from the effect of repositioning the fixed income asset portfolio (2016: £135 million). Favourable longevity assumption changes, reflecting updated actuarial mortality tables, contributed a further £204 million. This was offset partly by an increase of £225 million (2016: £175 million) in the provision related to the potential costs and related potential redress of reviewing internally vesting annuities sold without advice after 1 July 2008. The provision does not include potential insurance recoveries of up to £175 million.

2016 (AER) compared with 2015 (CER based on 2016 exchange rate)

Asia total operating profit of £1,644 million was 15 per cent higher than the previous year (28 per cent on an AER basis). Operating profit from life insurance operations in Asia was 15 per cent higher at £1,503 million (up 28 per cent on an actual exchange rate basis), reflecting our ability to translate top line growth into shareholder value. The performance is underpinned by the recurring premium income nature of our in-force book and the highly diverse nature of our earnings by geography and by source. Insurance income was up 24 per cent (38 per cent on an actual exchange rate basis), reflecting our continued focus on health and protection business. At a country level, we have seen double-digit growth in six markets, led by Hong Kong (up 40 per cent, and 59 per cent on an AER basis), China (up 83 per cent, and 100 per cent on an AER basis) and growth of 15 per cent or more (20 per cent or more on an AER basis) from Malaysia, Thailand, Vietnam and Taiwan. These markets have more than compensated for the impact of lower earnings growth in Indonesia and Singapore, following deliberate actions taken to improve the quality of new business flows. Eastspring's operating profit based on longer-term

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investment returns increased by 10 per cent (up 23 per cent on an actual exchange rate basis) to £141 million, reflecting the positive effect on average assets under management of favourable market movements and £2.2 billion net inflows in the second half of the year. Although a shift in the mix of assets away from higher-margin equity funds has moderated the overall revenue margin, scale efficiencies have resulted in an improvement in the cost-income ratio to 56 per cent (2015: 58 per cent).

US total operating profit of £2,048 million was 7 per cent higher than the previous year (20 per cent increase on an AER basis). US life operating profit was 8 per cent higher at £2,052 million (up 21 per cent on an actual exchange rate basis), reflecting the resilient performance of Jackson's franchise in an environment of market volatility and sector wide disruption following the announcement of the Department of Labor's fiduciary duty rule in April 2016. Average separate account balances increased by 5 per cent (17 per cent on an AER basis), resulting in a 3 per cent rise in fee income (16 per cent on an AER basis), while the result also benefited from scale efficiencies. As expected, lower yields in the year have impacted spread income, which decreased by 5 per cent (increased by 8 per cent on an AER basis).

UK and Europe total operating profit of £1,253 million was 23 per cent lower than the previous year. UK and Europe life operating profit declined by 32 per cent to £799 million (2015: £1,167 million). Within this total, the contribution from our core in-force with-profits and annuity business was £601 million (2015: £644 million), including an unchanged transfer to shareholders from the with-profits funds of £269 million. The balance of the result reflects the contribution from other activities which are either non-core or are not expected to recur to the same extent going forward. Profit from new annuity business reduced from £123 million in 2015 to £41 million, as we scaled down our participation in the annuity market. In response to the volatile investment market environment during 2016, we took a number of asset and liability actions to improve the solvency position of our UK life operations and further mitigate market risk, generating combined profits of £332 million (2015: £400 million). Of this amount, £197 million related to profit from longevity reinsurance transactions (2015: £231 million) and £135 million (2015: £169 million) from the effect of repositioning the fixed income asset portfolio. In response to the findings of the FCA's thematic review of non-advised annuity sales practices, the UK business will review internally vesting annuities sold without advice after 1 July 2008. Reflecting this, the UK life 2016 result includes a provision of £175 million for the cost of this review and related potential redress. The provision does not include potential insurance recoveries of up to £175 million. Asset management operating profit based on longer-term investment returns declined by 4 per cent to £425 million (2015: £442 million), reflecting the impact on revenues of lower average assets under management during the year, following the net outflows experienced since the second quarter of 2015. As these net outflows were primarily from the higher margin retail business, they had a disproportionately adverse impact on earnings. The same dynamics have seen the cost-income ratio move up 2 percentage points to 59 per cent.

Life insurance profit drivers

The increase in our operating profit levels reflects the growth in the scale of our operations, driven primarily by positive business flows. We track the progress that we make in growing our life insurance business by reference to the scale of our obligations to our customers, which are referred to in the financial statements as policyholder liabilities. Each year these increase as we write new business and collect regular premiums from existing customers and decrease as we pay claims and policies mature. The overall scale of these policyholder liabilities is relevant in the evaluation of our profit potential in that it reflects, for example, our ability to earn fees on the unit-linked element and indicates the scale of the insurance element, another key source of profitability for the Group.

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

	2017 Actual exchange rate				2016 Actual exchange rate			
	At 1 January	Net liability flows[9]	Market and other movements[3]	At 31 December	At 1 January	Net liability flows[9]	Market and other movements[3]	At 31 December
	£m	£m	£m	£m	£m	£m	£m	£m
Asia	**32,851**	**2,301**	**2,250**	**37,402**	25,032	2,086	5,733	32,851
US	**177,626**	**3,137**	**(39)**	**180,724**	138,913	5,198	33,515	177,626
UK and Europe	**56,158**	**(2,721)**	**2,930**	**56,367**	52,824	(3,646)	6,980	56,158
Total Group	**266,635**	**2,717**	**5,141**	**274,493**	216,769	3,638	46,228	266,635

Focusing on business supported by shareholder capital, which generates the majority of the life profit, in 2017 net flows into our businesses were overall positive at £2.7 billion driven by our US and Asian operations, as we continue to focus on both retaining our existing customers and attracting new business to drive long-term value creation. In the UK our shareholder liabilities includes the run-off of the in-force annuity portfolio following our effective withdrawal from selling new annuity business. This has been more than offset by inflows into the with-profits funds of £3.5 billion. Positive investment markets, offset partly by currency effects as sterling has strengthened over the period, increased liabilities by £5.1 billion. In total, business flows and market movements have increased shareholder-backed policyholder liabilities from £266.6 billion to £274.5 billion.

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

	2017 Actual exchange rate				2016 Actual exchange rate			
	At 1 January	Net liability flows[9]	Market and other movements[3]	At 31 December	At 1 January	Net liability flows[9]	Market and other movements[3]	At 31 December
	£m	£m	£m	£m	£m	£m	£m	£m
Asia	**29,933**	**4,574**	**1,930**	**36,437**	20,934	3,696	5,303	29,933
UK and Europe	**113,146**	**3,457**	**8,096**	**124,699**	100,069	1,119	11,958	113,146
Total Group	**143,079**	**8,031**	**10,026**	**161,136**	121,003	4,815	17,261	143,079

Policyholder liabilities in our with-profits business have increased by 13 per cent to £161.1 billion reflecting the growing popularity of our participating funds in Asia and PruFund in the UK, as consumers seek protection from some of the short-term ups and downs of direct stock market investments by using an established smoothing process. Across our Asia and UK operations, net liability flows increased to £8.0 billion. As returns from these funds are smoothed and shared with customers, the emergence of shareholder profit is more gradual. This business, nevertheless, remains an important source of future shareholder value.

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

	Actual exchange rate						Constant exchange rate			Actual exchange rate		
	2017			2016			2016			2015		
	Operating profit	Average liability	Margin bps	Operating profit	Average liability	Margin bps	Operating profit	Average liability	Margin bps	Operating profit	Average liability	Margin bps
	£m	£m		£m	£m		£m	£m		£m	£m	
Spread income	**1,108**	**88,908**	**125**	1,171	83,054	141	1,215	85,266	142	1,153	72,900	158
Fee income	**2,603**	**166,839**	**156**	2,175	139,451	156	2,280	145,826	156	1,888	123,232	153
With-profits	**347**	**136,474**	**25**	317	118,334	27	319	119,170	27	314	106,749	29
Insurance margin	**2,271**			1,991			2,083			1,671		
Margin on revenues	**2,286**			2,126			2,211			1,822		
Expenses:												
Acquisition costs	**(2,433)**	**6,958**	**(35)%**	(2,251)	6,320	(36)%	(2,353)	6,574	(36)%	(2,100)	5,466	(38)%
Administration expenses*	**(2,297)**	**261,114**	**(88)**	(1,943)	229,477	(85)	(2,025)	238,392	(85)	(1,656)	203,664	(81)
DAC adjustments	**505**			390			411			313		
Expected return on shareholder assets	**229**			221			227			224		
	4,619			4,197			4,368			3,629		
Longevity reinsurance and other management actions to improve solvency	**276**			332			332			400		
Changes in longevity assumption basis	**204**											
Provision for review of past annuity sales	**(225)**			(175)			(175)					
Operating profit based on longer-term investment returns	**4,874**			4,354			4,525			4,029		

* The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. The acquisition costs include only those relating to shareholders backed business.

We continue to maintain our preference for high-quality sources of income such as insurance margin from life and health and protection business and fee income. We favour insurance margin because it is relatively insensitive to the equity and interest rate cycle and prefer fee income to spread income because it is more capital-efficient. In line with this approach, on a constant exchange rate basis, insurance margin has increased by 9 per cent (up 14 per cent on an actual exchange rate basis) and fee income by 14 per cent (up 20 per cent on an actual exchange rate basis), while spread income decreased by 9 per cent (down 5 per cent on an actual exchange rate basis). Administration expenses increased to £2,297 million (2016: £2,025 million) as the business continues to expand. The expense margin has grown from 85 basis points to 88 basis points reflecting the continued increase in US producers selecting asset-based commissions which are treated as an administrative expense in this analysis.Refer to section I(a) within the "Additional unaudited financial information" for further information on operating profit based on longer-term investment returns by driver.

Asset management profit drivers

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

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Asset management external funds under management[11,12]

	2017 Actual exchange rate				2016 Actual exchange rate			
	At 1 January	Net flows	Market and other movements	At 31 December	At 1 January	Net flows	Market and other movements	At 31 December
	£m	£m	£m	£m	£m	£m	£m	£m
UK and Europe	**136,763**	**17,337**	**9,755**	**163,855**	126,405	(8,090)	18,448	136,763
Asia13	**38,042**	**3,141**	**5,385**	**46,568**	30,281	1,835	5,926	38,042
Total asset management	**174,805**	**20,478**	**15,140**	**210,423**	156,686	(6,255)	24,374	174,805
Total asset management (including MMF)	**182,519**	**21,973**	**15,248**	**219,740**	162,692	(5,852)	25,679	182,519

2017 compared with 2016 (CER)

In 2017, average assets under management in our asset management businesses in the UK and Asia benefited from positive net inflows of assets and favourable markets, driving higher fee revenues. Reflecting this, operating profit derived from asset management activities in M&G Prudential increased by 18 per cent to £500 million and in Eastspring by 18 per cent (up 25 per cent on an actual exchange rate basis) to £176 million.

M&G Prudential's external assets under management have benefited from a record level of net inflows, reflecting improvement in investment performance and supportive markets. External asset management net inflows totalled £17.3 billion (2016: net outflows of £8.1 billion), with significant contributions from European investors in the Optimal Income Fund, Global Floating Rate High Yield Fund and multi-asset range, and from institutional clients, notably within our public debt, illiquid credit strategies and infrastructure equity funds. External assets under management increased 20 per cent to £163.9 billion during the year. Internal assets benefiting from PruFund sales and favourable markets increased 7 per cent, taking total M&G Prudential assets under management to £350.7 billion (2016: £310.8 billion).

Eastspring also attracted good levels of external net inflows during the year across its equity, fixed income and balanced fund range, totalling £3.1 billion, excluding money market funds (2016: £1.8 billion on an actual exchange rate basis). Overall external assets under management increased by 22 per cent to £46.6 billion. Combined with higher internal assets under management and money market funds lifted Eastspring's total assets under management to £138.9 billion.

2016 (AER) vs 2015 (CER based on 2016 exchange rates)

M&G Prudential asset management business's external assets under management at 31 December 2016 were 8 per cent higher than a year ago at £136.8 billion, benefitting from positive investment market movements, particularly in the second half of the year and a return to positive net flows for retail business in the fourth quarter of £942 million. Including the assets managed for internal life operations, M&G Prudential asset management business's total assets under management rose to £264.9 billion (2015: £246.1 billion).

Eastspring investment's external assets under management at 31 December 2016 increased to £38.0 billion (31 December 2015: £30.3 billion). Including money market funds and the assets managed for internal life operations, Eastspring Investment's total assets under management rose to a record £117.9 billion (2015: £89.1 billion).

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Other income and expenditure and restructuring costs[1]

Higher interest costs following the debt issued in 2016 and 2017, and restructuring costs of £103 million, as the business invests for the future, including UK and Europe infrastructure, contributed to an increase in net central expenditure of £139 million to £878 million (2016: £732 million on an actual exchange rate basis).

Non-operating items[1]

2017 compared with 2016 (CER)

Non-operating items consist of short-term fluctuations in investment returns on shareholder-backed business of negative £1,563 million (2016: negative £1,764 million), the results attaching to disposal of businesses of £223 million (2016: negative £244 million), and the amortisation of acquisition accounting adjustments of negative £63 million (2016: negative £79 million) arising mainly from the REALIC business acquired by Jackson in 2012. The profit attributable to disposal of businesses relates to amounts in respect of the Korea life business sold in 2017 and the disposal of the US broker-dealer network in August 2017.

2016 (AER) compared with 2015 (CER based on 2016 exchange rates)

The result of the held for sale Korea business, a loss of £227 million, comprises both the write down of the IFRS net assets to sales proceeds (net of costs) and the profits for the year. The comparative profits for the year have been similarly reclassified as non-operating for consistency of presentation. Other non-operating items of negative £76 million mainly represent the amortisation of acquisition accounting adjustments arising principally on the acquisition of the REALIC business in 2012 (2015: negative £85 million on a constant exchange rate basis). Additionally, 2015 non-operating items included a loss of £46 million from the recycling of exchange losses on the sale of the Japan business.

Short-term fluctuations in investment returns on shareholder-backed business represent the most significant component of non-operating items and are discussed further below.

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

Operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns.

2017

In 2017, the total short-term fluctuations in investment returns on shareholder-backed business were negative £1,563 million and comprised negative £1 million for Asia, negative £1,568 million in the US, negative £14 million in the UK and positive £20 million in other operations.

In the US, Jackson provides certain guarantees on its annuity products, the value of which would rise typically when equity markets fall and long-term interest rates decline. Jackson includes the expected cost of hedging when pricing its products and charges fees for these guarantees which are used, as necessary, to purchase downside protection in the form of options and futures to mitigate the effect of equity market falls, and swaps and swaptions to cushion the impact of declines in long-term interest rates. Under IFRS, accounting for the movement in the valuation of these derivatives, which are all fair valued, is asymmetrical to the movement in guarantee liabilities, which are not fair valued in all cases. Jackson designs its hedge programme to protect the capital and economics of the business from large movements in investment markets and accepts the variability in accounting results. The negative short-term fluctuations in investment returns on shareholder-backed business of £1,568 million in the year are attributable mainly to the net value movement in the period of the hedge instruments held to

manage market exposures and reflect the positive equity market performance in the US during the period.

2016

In 2016, the total short-term fluctuations in investment returns were negative £1,678 million and comprised negative £225 million for Asia, negative £1,455 million in the US, positive £206 million in the UK and negative £204 million in other operations.

The Asia negative £225 million short-term fluctuations principally reflected the net impact of changes in interest rates and equity markets across the region.

US negative short-term fluctuations of £1,455 million in the year mainly reflect the effect of the increase in equity markets on net value movements on the guarantees and associated derivatives with the S&P 500 index closing at 10 per cent higher than at the start of the year. While the resulting negative mark-to-market movements on these hedging instruments are recorded in 2016, the related increases in fee income that arise from the higher asset values managed, will be recognised and reported in future years.

The UK non-operating profit of positive £206 million mainly reflects gains on bonds backing annuity capital and shareholders' funds following the 70bps fall in 15-year UK gilt yields in 2016.

The negative short-term fluctuations in investment returns for other operations of negative £204 million (2015: negative £73 million) include unrealised value movements on financial instruments.

2015

In 2015, the total short-term fluctuations in investment returns were negative £755 million, comprising negative £137 million for Asia, negative £424 million in the US, negative £121 million in the UK and Europe and negative £73 million in other operations.

In Asia, the negative short-term fluctuations of £137 million reflected net unrealised losses on fixed income securities, primarily due to rises in bond yields.

Short-term fluctuations in the US mainly reflect the net value movement on the guarantees offered by Jackson and the associated derivatives held to manage market exposures. Under IFRS accounting the movement in the valuation of derivatives, which are fair valued, is asymmetrical to the movement in the guarantee liabilities, which are not fair valued in all cases. Jackson designs its hedge programme to protect the economics of the business from large movements in investment markets and therefore accepts variability in the accounting results. The negative short-term fluctuations of £424 million in 2015 were primarily attributable to the net value movement in the year of the hedge instruments held to manage market exposures.

Negative short-term fluctuations of £121 million in the UK reflected net unrealised losses on fixed income assets supporting the excess capital held within the shareholder-backed annuity business following a rise in interest rates during the year.

IFRS effective tax rates

In 2017, the effective tax rate on operating profit based on longer-term investment returns was 21 per cent, which is unchanged from 2016 (21 per cent, 2015: 20 per cent).

The 2017 effective tax rate on the total IFRS profit was 27 per cent (2016: 16 per cent, 2015: 18 per cent), reflecting the inclusion of a £445 million one-off charge on the re-measurement of US deferred tax balances using a rate of 21 per cent (previously 35 per cent) following the enactment in December

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2017 of a comprehensive US tax reform package. Excluding this one-off charge, the 2017 effective tax rate would have been 14 per cent.

In addition to the impact on the IFRS profit, the re-measurement of US deferred tax balances also resulted in a separate benefit of £134 million recognised in other comprehensive income, in relation to changes to deferred tax on cumulative unrealised gains (net of DAC) on bonds which are taken directly through other comprehensive income.

The main driver of the Group's effective tax rate is the relative mix of the profits between jurisdictions with higher tax rates (such as Indonesia and Malaysia), jurisdictions with lower tax rates (such as Hong Kong and Singapore), and jurisdictions with rates in between (such as the UK, and now from 2018, the US).

Once the US tax changes are fully reflected, we would expect a favourable impact on the Group's effective tax rate. The US operating profit effective tax rate is expected to be circa 18 per cent (previously 28 per cent), and the overall Group operating profit effective tax rate is likely to settle in the range of 16 per cent to 18 per cent.

Total tax contribution

The Group continues to make significant tax contributions in the jurisdictions in which it operates, with £2,903 million remitted to tax authorities in 2017. This was similar to the equivalent amount of £2,887 million in 2016 and lower than the equivalent amount of £3,004 million in 2015.

Tax strategy

In May 2017 the Group published its tax strategy, which in addition to complying with the mandatory UK (Finance Act 2016) requirements, also included a number of additional disclosures, including a breakdown of revenues, profits and taxes for all jurisdictions where more than £5 million tax was paid. This disclosure was included as a way of demonstrating that our tax footprint (ie where we pay taxes) is consistent with our business footprint. An updated version of the tax strategy, including 2017 data, will be available on the Group's website before 31 May 2018.

Group and holding company cash flows

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

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

Cash remitted to the corporate centre in 2017 amounted to £1,788 million, driven by higher remittances from Asia. For the first time, our Asia business unit is the largest contributor[14] to cash in the Group, demonstrating the quality and scale of its growth. Jackson made sizeable remittances of £475 million. The remittance from M&G Prudential of £643 million was 9 per cent higher than the combined remittance in 2016. Prudential Capital contributed a further £25 million.

Cash remitted to the Group in 2017 was used to meet central costs of £470 million (2016: £416 million) and pay the 2016 second interim and 2017 first interim dividends respectively. These movements and other corporate cash flows, including a net reduction in core structural borrowings and the impact of

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currency movements, led to holding company cash decreasing from £2,626 million to £2,264 million over 2017.

Capital position, financing and liquidity

Capital position

Analysis of movement in Group shareholder Solvency II surplus[15]

	2017	2016
	£bn	£bn
Solvency II surplus at 1 January	**12.5**	9.7
Operating experience	**3.6**	2.7
Non-operating experience (including market movements)*	**(0.6)**	(1.1)
Other capital movements:		
Subordinated debt (redemption) / issuance	**(0.2)**	1.2
Foreign currency translation impacts	**(0.7)**	1.6
Dividends paid	**(1.2)**	(1.3)
Model changes	**(0.1)**	(0.3)
Estimated Solvency II surplus at 31 December	**13.3**	12.5

* 2017 includes a £(0.6) billion reduction in deferred tax assets following US tax reform.

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in an increase in the Group's shareholders' Solvency II capital surplus which is estimated at £13.3 billion[5,6], at 31 December 2017 (equivalent to a solvency ratio of 202 per cent), compared with £12.5 billion (201 per cent) at 31 December 2016. In 2017 we generated £3.6 billion of operating capital. This was offset by dividends to shareholders, net repayment of subordinated debt, adverse foreign currency effects and the £0.6 billion reduction in statutory deferred tax asset following US tax reform.

Prudential has been designated as a Global Systemically Important Insurer (G-SII) and is monitoring and engaging with the PRA on the development and potential impact of the policy measures associated with such a designation.

Local statutory capital

All of our subsidiaries continue to hold appropriate capital levels on a local regulatory basis. In the UK, at 31 December 2017 The Prudential Assurance Company Limited and its subsidiaries[16] had an estimated Solvency II shareholder surplus[17] of £6.1 billion (equivalent to a cover ratio of 178 per cent) and a with-profits surplus[18] of £4.8 billion (equivalent to a cover ratio of 201 per cent). In the US, following the enactment in December 2017 of a comprehensive reform package, a £628 million reduction in the level of the statutory net admitted deferred tax asset more than offset operational capital formation, resulting in a Risk Based Capital ratio of 409 per cent (2016: 485 per cent).

Debt portfolio

The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders' exposure to credit is concentrated in the UK annuity portfolio and the US general account, mainly attributable to Jackson's fixed annuity portfolio. The credit exposure is well diversified and 98 per cent of our UK portfolio and 97 per cent of our US portfolio are investment grade[19]. During 2017, default losses were minimal and reported impairments across the UK and US portfolios were £2 million (2016: £35 million).

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Financing and liquidity

Shareholders' net core structural borrowings and ratings

	31 December 2017	2016
	£m	**£m**
Total borrowings of shareholder-financed operations	**6,280**	6,798
Less: Holding company cash and short-term investments	**(2,264)**	(2,626)
Net core structural borrowings of shareholder-financed operations	**4,016**	4,172
Gearing ratio*	**20%**	22%

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

The Group had central cash resources of £2.3 billion at 31 December 2017 (31 December 2016: £2.6 billion). Total core structural borrowings reduced by £0.5 billion, from £6.8 billion to £6.3 billion, with the issue of US$750 million (£547 million at 31 December 2017) 4.875 per cent tier 2 perpetual subordinated debt in October 2017 being more than offset by the redemption of US$1 billion (£741 million at 31 December 2017) 6.5 per cent tier 2 perpetual subordinated debt in December 2017.

In addition to its net core structural borrowings of shareholder-financed operations set out above, the Group also has access to funding via the money markets and has in place an unlimited global commercial paper programme. As at 31 December 2017, we had issued commercial paper under this programme totalling US$650 million, to finance non-core borrowings.

Prudential's holding company currently has access to £2.6 billion of syndicated and bilateral committed revolving credit facilities provided by 19 major international banks, expiring in 2022. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2017. The medium-term note programme, the US shelf programme (platform for issuance of SEC registered public bonds in the US market), the commercial paper programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential's holding company and are intended to maintain a flexible funding capacity.

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Movement in Shareholders' Funds

The following table sets forth a summary of the movement in Prudential's IFRS shareholders' funds for 2017 and 2016:

Shareholders' funds

	2017	2016
	£m	£m
Profit after tax for the year[20]	**2,389**	1,921
Exchange movements, net of related tax	**(409)**	1,161
Cumulative exchange gain of Korea life business recycled to profit and loss account	**(61)**	
Unrealised gains and losses on Jackson fixed income securities classified as available for sale[21]	**486**	31
Dividends	**(1,159)**	(1,267)
Other	**175**	(135)
Net increase in shareholders' funds	**1,421**	1,711
Shareholders' funds at 1 January	**14,666**	12,955
Shareholders' funds at 31 December	**16,087**	14,666
Shareholders' value per share[22]	**622p**	568p
Return on shareholders' funds[23]	**25%**	26%

Group IFRS shareholders' funds at 31 December 2017 increased by 10 per cent to £16.1 billion (31 December 2016: £14.7 billion on an actual exchange rate basis), driven by the strength of the operating result, offset by dividend payments of £1,159 million. During the period, UK sterling has strengthened relative to the US dollar and various Asian currencies. With approximately 50 per cent of the Group's IFRS net assets denominated in non-sterling currencies, this generated a negative exchange rate movement on the net assets in the period. In addition, the moderate decline in US long-term interest rates between the start and the end of the reporting period produced unrealised gains on fixed income securities held by Jackson accounted through other comprehensive income.

Corporate transactions

Intention to demerge the Group's UK businesses and sale of £12.0 billion[24] UK annuity portfolio

In March 2018, the Group announced its intention to demerge its UK and Europe businesses ('M&G Prudential') from Prudential plc, resulting in two separately-listed companies. On completion of the demerger, shareholders will hold interests in both Prudential plc and M&G Prudential.

In preparation for the UK demerger process, and to align the ownership of the Group's businesses with their operating structures, Prudential plc intends to transfer the legal ownership of its Hong Kong insurance subsidiaries from The Prudential Assurance Company Limited (M&G Prudential's UK regulated insurance entity) to Prudential Corporation Asia Limited, which is expected to complete by the end of 2019.

M&G Prudential agreed in March 2018 to the sale of £12.0 billion[24] of its shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured £12.0 billion[24] of liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The capital benefit of this transaction will be retained within the Group to support the demerger process.

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The IFRS liabilities relating to M&G Prudential's total UK shareholder annuity portfolio as at 31 December 2017 were £32.6 billion. The UK annuity business being sold contributed around £140 million towards UK life insurance core[4] IFRS operating profit before tax of £597 million in 2017. Total M&G Prudential IFRS operating profit before tax was £1,378 million in 2017.

Based on asset and liability values as at 31 December 2017, the transaction is estimated to give rise to a pre-tax IFRS loss of around £500 million in the first half of 2018, alongside the de-risking being achieved.

Prudential plc's Hong Kong subsidiaries which are subject to legal transfer from The Prudential Assurance Company Limited to Prudential Corporation Asia Limited comprise its life business, Prudential Hong Kong Limited, and its general insurance business, Prudential General Insurance Hong Kong Limited. Hong Kong will continue to be included in the segmental reporting of Asia's IFRS and embedded value results. The transfers will be subject to regulatory approval.

The sale of the UK annuity portfolio and the transfer of Prudential plc's Hong Kong subsidiaries to Asia are expected to complete by the end of 2019. Assuming that these actions had both been completed as at 31 December 2017, the Group's embedded value of £44.7 billion is estimated to reduce by approximately £300 million, reflecting the loss of future profits on the portion of annuity liabilities being sold.

The estimated pro-forma impact on the Group shareholder Solvency II capital position, assuming that these actions had both been completed as at 31 December 2017, is an increase in surplus of £0.3 billion and an increase in the shareholder solvency ratio of 6 percentage points.

Pro-forma estimated Group shareholder Solvency II capital position

	Own Funds	Solvency Capital Requirement	Surplus	Ratio
	£bn	£bn	£bn	%
31 December 2016 as reported	24.8	12.3	12.5	201
31 December 2017 as reported	26.4	13.1	13.3	202
31 December 2017 pro-forma estimate*	26.2	12.6	13.6	208

* The pro-forma estimate assumes that the partial sale of the UK annuity portfolio and the transfer of Prudential plc's Hong Kong subsidiaries to Asia had both been completed as at 31 December 2017.

On the same basis, the estimated pro-forma impact on the shareholder Solvency II capital position of the UK regulated insurance entity, The Prudential Assurance Company Limited, is provided in the table below. This pro-forma solvency position reflects the reduced risk exposures in the UK insurance entity after the partial annuity sale and Hong Kong transfer.

Pro-forma estimated The Prudential Assurance Company Limited shareholder Solvency II capital position

	Own Funds	Solvency Capital Requirement	Surplus	Ratio
	£bn	£bn	£bn	%
31 December 2016 as reported	12.0	7.4	4.6	163
31 December 2017 as reported	14.0	7.9	6.1	178
31 December 2017 pro-forma estimate*	8.5	5.7	2.8	150

* The pro-forma estimate assumes that the partial sale of the UK annuity portfolio and the transfer of Prudential plc's Hong Kong subsidiaries to Asia had both been completed as at 31 December 2017. In relation to the sale of the UK annuity portfolio, this estimate includes a £1.3 billion reduction in the Solvency Capital Requirement (SCR) and a £0.2 billion

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decrease in Own Funds, resulting in an increase in capital surplus of £1.1 billion, of which £0.6 billion is expected to be recognised in the UK capital position as at 30 June 2018 under the reinsurance agreement. In relation to the Hong Kong transfer, the impact on the SCR allows for the release of the Hong Kong business standalone SCR of £2.0 billion, partially offset by the removal of diversification benefits between UK and Hong Kong of £1.1 billion.

2017

Entrance into Nigeria

In July 2017 the Group acquired a majority stake in Zenith Life of Nigeria and formed exclusive bancassurance partnerships with Zenith Bank in Nigeria and Ghana. The acquisition and bancassurance partnerships will see Prudential enter the market in Nigeria, Africa's largest economy, with a population of over 180 million. This expands Prudential's regional platform in Africa following the launch of businesses in Ghana and Kenya in 2014, in Uganda in 2015 and Zambia in 2016.

Disposal of Korea life

In May 2017, the Group completed the sale of the Group's life insurance subsidiary in Korea, PCA Life Insurance Co. Ltd to Mirae Asset Life Insurance Co. Ltd. for KRW170 billion (equivalent to £117 million at 17 May 2017 closing rate).

Disposal of broker-dealer network in the US

In August 2017, the Group, through its subsidiary National Planning Holdings, Inc. ('NPH') sold its US independent broker-dealer network to LPL Financial LLC for an initial purchase price of US$325 million (equivalent to £252 million at 15 August 2017).

2016

Entrance into Zambia

In June 2016 we completed the acquisition of Professional Life Assurance of Zambia, increasing Prudential's insurance business footprint in Africa to four markets. Across Ghana, Kenya, Uganda and now Zambia we are gradually laying the foundations for what we hope will become a meaningful component of the Group in the years to come. Our current focus in these businesses is on growing our distribution; at 31 December we had 1,750 agents and were active in 181 branches of our four local bank partners (three exclusive) across these businesses.

2015

In June 2015, we completed the acquisition of Ugandan company Goldstar Life Assurance and signed a long-term co-operation agreement with Crane Bank of Uganda.

Dividend

The Board has decided to increase the full-year ordinary dividend by 8 per cent to 47 pence per share, reflecting our 2017 financial performance and our confidence in the future prospects of the Group. In line with this, the directors have approved a second interim ordinary dividend of 32.5 pence per share (2016: 30.57 pence per share).

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

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Notes

1. Refer to note B1.1 in consolidated financial statements for the breakdown of other income and expenditure and other non-operating items.
2. Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
3. The 2016 and 2015 comparative results have been re-presented from those published previously, following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.
4. Core refers to the underlying profit of the UK and Europe insurance business excluding the effect of, for example, management actions to improve solvency and material assumption changes. Details of these are set out in note I(d) of the Additional unaudited IFRS financial information.
5. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.
6. Before allowing for second interim ordinary dividend.
7. Gross earned premiums for contracts in second and subsequent years, comprising Asia segment IFRS gross earned premium of £15.7 billion less gross earned premiums relating to new regular and single premiums of £5.7 billion, plus renewal premiums from joint ventures of £1.6 billion, and excluding any amounts relating to the sold Korea life business.
8. Includes Group's proportionate share of the liabilities and associated flows of the insurance joint ventures and associates in Asia.
9. Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.
10. Includes Unallocated surplus of with-profits business.
11. Includes Group's proportionate share in PPM South Africa and the Asia asset management joint ventures.
12. For our asset management business the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(a) of the Additional unaudited financial information.
13. Net inflows exclude Asia Money Market Fund (MMF) inflows of £1,495 million (2016: net inflows £403 million). External funds under management exclude Asia MMF balances of £9,317 million (2016: £7,714 million).

14. Based on the 2017 operating segments.
15. The methodology and assumptions used in calculating the Solvency II capital results are set out in note II(e) of the Additional unaudited financial information.
16. The insurance subsidiaries of The Prudential Assurance Company Limited are Prudential General Insurance Hong Kong Limited, Prudential Hong Kong Limited, Prudential International Assurance plc and Prudential Pensions Limited.
17. The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.
18. The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.
19. Based on hierarchy of Standard and Poor's, Moody's and Fitch, where available and if unavailable, internal ratings have been used.
20. Excluding profit for the year attributable to non-controlling interests.
21. Net of related charges to deferred acquisition costs and tax.
22. Closing shareholders' funds divided by issued shares, as set out in note II(d) of the Additional unaudited financial information.
23. Operating profit after tax and non-controlling interests as percentage of opening shareholders' funds, as set out in note II(b) of the Additional unaudited financial information.
24. Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.

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

The following table shows Prudential's consolidated total revenue and consolidated total charges for the years presented:

	Actual Exchange Rate		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Gross premiums earned[(a)]	**44,005**	38,981	36,663
Outward reinsurance premiums	**(2,062)**	(2,020)	(1,157)
Earned premiums, net of reinsurance	**41,943**	36,961	35,506
Investment return[(b)]	**42,189**	32,511	3,304
Other income	**2,430**	2,370	2,495
Total revenue, net of reinsurance	**86,562**	71,842	41,305
Benefits and claims	**(71,854)**	(60,948)	(30,547)
Outward reinsurers' share of benefit and claims	**2,193**	2,412	1,389
Movement in unallocated surplus of with-profits funds	**(2,871)**	(830)	(498)
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance[(c)]	**(72,532)**	(59,366)	(29,656)
Acquisition costs and other expenditure[(d)]	**(10,165)**	(8,848)	(8,208)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(425)**	(360)	(312)
Disposal of Korea life business:			
Cumulative exchange gain recycled from other comprehensive income	**61**		
Remeasurement adjustments	**5**	(238)	
Gain on disposal of other businesses	**162**		
Disposal of Japan life business cumulative exchange loss recycled from other comprehensive income			(46)
Total charges, net of reinsurance and gain (loss) on disposal of businesses	**(82,894)**	(68,812)	(38,222)
Share of profits from joint ventures and associates, net of related tax	**302**	182	238
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)**	**3,970**	3,212	3,321
Less tax charge attributable to policyholders' returns	**(674)**	(937)	(173)
Profit before tax attributable to shareholders	**3,296**	2,275	3,148
Total tax charge attributable to policyholders and shareholders	**(1,580)**	(1,291)	(742)
Adjustment to remove tax charge attributable to policyholders' returns	**674**	937	173
Tax charge attributable to shareholders' returns	**(906)**	(354)	(569)
Profit for the year	**2,390**	1,921	2,579

*

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

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(a) Gross premiums earned

	Year ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Asia	**15,688**	14,006	10,814
US	**15,164**	14,685	16,887
UK and Europe	**13,126**	10,290	8,962
Unallocated to a segment	**27**		
Total	**44,005**	38,981	36,663

Gross premiums earned for insurance operations totalled £44,005 million in 2017, up 13 per cent from £38,981 million in 2016. The increase of £5,024 million was primarily driven by growth of £2,836 million in the UK and Europe operations , £1,682 million in the Asia operations and £479 million in the US operations.

Gross premiums earned for insurance operations totalled £38,981 million in 2016, up 6 per cent from £36,663 million in 2015. The increase of £2,318 million was driven by growth of £1,328 million in the UK and Europe operations and £3,192 million in the Asia operations, which was partially offset by a decline of £2,202 million in the US operations.

Asia

Gross premiums earned reflect the aggregate of single and recurrent premiums of new business sold in the year and premiums on annual business sold in previous years.

Gross premiums for Asia increased by 12 per cent from £14,006 million in 2016 to £15,688 million in 2017 on an actual exchange rate basis. Excluding the impact of exchange translation, gross earned premiums in Asia increased by 7 per cent from 2016 to 2017, from £14,691 million on a constant exchange rate in 2016 to £15,688 million in 2017. The growth in earned premiums reflects the continued growth of our in-force recurring premium business.

Our focus on quality is undiminished with regular premium contracts accounting for majority of the sales and driven by a health and protection focus. This focus provides a high level of recurring income and an earnings profile that is significantly less correlated to investment markets.

In Hong Kong, in 2017 we continue to focus on driving growth in health and protection business. This targeted shift to higher margin, but lower case size protection business, aligned with the de-emphasis of broker sales and the expected moderation in the level of sales from Mainland China has resulted in a reduction in Hong Kong sales of new business but its overall gross premiums earned have increased year on year from the increase in in-force recurring premium reflecting the higher level of new business sales in recent years.

Outside Hong-Kong, sales were up. In China, there were higher sales and a significant uplift in regular premium health and protection business from our increased scale and productivity in the agency channel, as well as a positive contribution from our bancassurance partners. In Singapore, sales grew, reflecting growth across both agency and bancassurance channels. Indonesia reflected a more stable sales performance than in recent years.

Gross premiums for Asia increased by 30 per cent from £10,814 million in 2015 to £14,006 million in 2016. Excluding the impact of exchange translation, gross premiums in Asia increased by 16 per cent from 2015 to 2016, from £12,067 million on a constant exchange rate in 2015 to £14,006 million in 2016. The growth in the premiums reflected increases for both the new business sold in the year and premiums on annual business sold in previous years. Sales of new business in the region grew which

reflected strong sales progression in the agency channel, as we continued to drive improvements in productivity and invest in recruitment initiatives to underpin future sales prospects. The fourth quarter of 2016 saw an acceleration in the positive trends observed earlier in 2016, with 8 of our markets in the region seeing considerable growth.

United States

Gross premiums increased by 3 per cent from £14,685 million in 2016 to £15,164 million in 2017 on an actual exchange rate basis. Excluding the impact of exchange translation, gross premiums in the US decreased by 2 per cent from £15,434 million on a constant exchange rate in 2016 to £15,164 million in 2017. Uncertainty regarding the application and implementation of the US Department of Labor Fiduciary Duty Rule has led to continued pressure on industry sales in 2017 which were down 11 per cent over the first nine months of the year. Despite this, Jackson's variable annuity sales increased marginally, with the economics on new business in variable annuities remaining extremely attractive, with high internal rates of return and short payback periods. Net inflows into Jackson's separate account asset balances, which drive fee-based earnings on variable annuity business, remained positive at £3.5 billion. The marginal increase in the variable annuity sales was more than offset by decreases in the sales of fixed annuity and fixed index annuity.

Gross premiums decreased by 13 per cent from £16,887 million in 2015 to £14,685 million in 2016 on an actual exchange rate basis. Excluding the impact of exchange translation, gross premiums in the US decreased by 23 per cent from £19,053 million on a constant exchange rate in 2015 to £14,685 million in 2016. In the US, uncertainty following the announcement of the Department of Labor's fiduciary duty rule on the distribution of retirement market products has contributed to a marked decline of 22 per cent in industry sales of variable annuities. Jackson's sales from all variable annuity products were also lower as a result. Notwithstanding this reduction in sales, net inflows into Jackson's separate account asset balances, which drive fee-based earnings on variable annuity business, remained positive at £4.4 billion.

UK and Europe

Gross premiums for UK and Europe life business increased by 28 per cent from £10,290 million in 2016 to £13,126 million in 2017, mainly due to our on-going strategy of extending customer access to PruFund's with-profits investment option via additional product wrappers which continues to drive growth. We have seen notable success with the build out of PruFund through individual pensions, income drawdown and ISAs. Reflecting this performance, total PruFund assets under management of £35.9 billion as at 31 December 2017 were 46 per cent higher than at the start of the year.

Gross premiums for UK and Europe increased by 15 per cent from £8,962 million in 2015 to £10,290 million in 2016, mainly due to our strategy of extending customer access to PruFund's with-profits investment option via additional product wrappers continues to drive growth in sales. In the low interest rate environment, consumers were attracted to PruFund's smoothed multi-asset fund returns and the financial security attaching to its strong capitalisation. Notable success was seen with the build out of PruFund through individual pensions, income drawdown and ISAs. Reflecting this strong performance, total PruFund assets under management of £24.7 billion as at 31 December 2016 were 50 per cent higher than at the start of the year. Despite this increase, sales from new annuity business reduced from £123 million in 2015 to £41 million in 2016, as we scaled down our participation in the annuity market.

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(b) Investment return

	Year ended 31 December		
	2017	**2016***	**2015***
	£m	**£m**	**£m**
Asia	**8,995**	2,917	(296)
US	**18,533**	7,612	(789)
UK and Europe	**14,584**	22,095	4,407
Unallocated to a segment and intra-segment elimination	**77**	(113)	(18)
Total	**42,189**	32,511	3,304

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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

Allocation of investment return between policyholders and shareholders

Investment return is attributable to policyholders and shareholders. A key feature of the accounting policies under IFRS is that the investment return included in the income statement relates to all investment assets of the Group, irrespective of whether the return is attributable to shareholders, or to policyholders or the unallocated surplus of with-profits funds, the latter two of which have no direct

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impact on shareholders' profit. The table below provides a breakdown of the investment return for each regional operation attributable to each type of business.

	2017	2016*	2015*
	£m	£m	£m
Asia			
Policyholder returns			
Assets backing unit-linked liabilities	**2,720**	822	(626)
With-profits business	**4,689**	1,454	(75)
	7,409	2,276	(701)
Shareholder returns	**1,586**	641	405
Total	**8,995**	2,917	(296)
US			
Policyholder returns Assets held to back separate account (unit-linked) liabilities	**19,198**	7,917	(2,033)
Shareholder returns	**(665)**	(305)	1,244
Total	**18,533**	7,612	(789)
UK and Europe			
Policyholder returns			
Scottish Amicable Insurance Fund (SAIF)	**368**	874	212
Assets held to back unit-linked liabilities	**2,111**	3,134	699
With-profits fund (excluding SAIF)	**10,108**	13,224	3,131
	12,587	17,232	4,042
Shareholder returns	**1,997**	4,863	365
Total	**14,584**	22,095	4,407
Unallocated to a segment			
Shareholder returns	**77**	(113)	(18)
Group Total			
Policyholder returns	**39,194**	27,425	1,308
Shareholder returns	**2,995**	5,086	1,996
Total	**42,189**	32,511	3,304

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

Policyholder returns

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

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

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

With-profits business (excluding SAIF) in UK and Europe and in Asia (in which the shareholders' economic interest, and the basis of recognising IFRS basis profits, is restricted to a share of the actuarially determined surplus for distribution (in the UK 10 per cent)). Except for this surplus the

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investment returns of the with-profits funds are attributable to policyholders (through the asset-share liabilities) or the unallocated surplus, which is accounted for as a liability under IFRS 4.

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

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

Shareholder returns

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

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

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

Reasons for year-on-year changes in investment returns

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

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

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(ii)

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

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

Asia

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

	Year ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Interest/dividend income (including foreign exchange gains and losses)	**1,685**	1,513	1,028
Investment appreciation (depreciation)	**7,310**	1,404	(1,324)
Total	**8,995**	2,917	(296)

In Prudential's Asia operations, debt securities accounted for 54 per cent, 55 per cent and 57 per cent of the total investment portfolio as at 31 December 2017, 2016 and 2015, respectively, with equities comprising 39 per cent, 36 per cent and 38 per cent, respectively. The remaining 7 per cent, 9 per cent and 5 per cent of the total investment portfolio, respectively, primarily comprised loans and deposits with credit institutions. Investment return increased from a gain of £2,917 million in 2016 to a gain of £8,995 million in 2017. This increase was due primarily to an increase of £5,906 million in investment appreciation from £1,404 million in 2016 to £7,310 million in 2017, principally reflecting more favourable equity market performance compared with 2016 and increased unrealised gains on US treasuries held by certain business units. These increases have a more significant impact on the with-profits funds and unit-linked business of the Asia operations.

Investment return increased from a loss of £296 million in 2015 to a gain of £2,917 million in 2016. This increase was due primarily to an increase of £2,728 million in investment appreciation compared with £1,324 million of depreciation in 2015 and an appreciation of £1,404 million in 2016. The changes in the equity markets and the interest rates affecting the value movement in debt securities during 2016 have been mixed across the region. The gain of £2,728 million was driven primarily by favourable change in the debt securities and equities held by the with-profits funds and unit-linked business of the Asia operations.

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United States

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

	Year ended 31 December		
	2017	2016	2015
	£m	£m	£m
Investment return of investments backing US separate account liabilities	**19,198**	7,917	(2,033)
Other investment return	**(665)**	(305)	1,244
Total	**18,533**	7,612	(789)

In the US, investment return increased from £7,612 million in 2016 to £18,533 million in 2017. This £10,921 million favourable change arose from an increase of £11,281 million in the investment return on investments backing variable separate account liabilities from £7,917 million in 2016 to £19,198 million in 2017 partly offset by a decrease of £360 million in other investment return from a loss of £305 million to a loss of £665 million. The primary driver for the £11,281 million increase in investment return on investments backing variable annuity separate account liabilities as compared with 2016 was the more favourable movements in US equity markets in 2017 compared with 2016. The decrease of £360 million in other investment returns primarily reflects a decrease in the realised gains and losses on the available-for-sale debt securities recorded in the income statement, which decreased from a realised gain of £376 million in 2016 to a realised loss of £43 million in 2017.

Investment return increased from a loss of £789 million in 2015 to a gain of £7,612 million in 2016. This £8,401 million favourable change arose from an increase of £9,950 million in the investment return on investments backing variable separate account liabilities from a loss of £2,033 million in 2015 to a gain of £7,917 million in 2016 and a decrease of £1,549 million in other investment return from a gain of £1,244 million to a loss of £305 million. The primary driver for the £9,905 million increase in investment return on investments backing variable annuity separate account liabilities as compared with 2015 was the favourable movements in the US equity markets in 2016 on a larger separate account asset balance. The decrease in other investment return reflects the value movements in derivatives held to manage interest rate and equity risk exposures as discussed in note B1.2 to the consolidated financial statements.

UK and Europe

The table below provides an analysis of investment return attributable to the UK & Europe operations for the years presented:

	Year ended 31 December		
	2017	2016*	2015*
	£m	£m	£m
Interest/dividend income	**6,183**	6,019	6,430
Investment appreciation (depreciation) and other investment return	**8,401**	16,076	(2,023)
Total	**14,584**	22,095	4,407

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

In Prudential's UK and Europe operations, equities accounted for 31 per cent, 29 per cent and 28 per cent of the total investment portfolio as at 31 December 2017, 2016 and 2015, respectively. Debt securities comprised 46 per cent, 50 per cent and 51 per cent, respectively, with investment properties

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accounting for 8 per cent in every year. The remaining 15 per cent, 13 per cent and 13 per cent of the total investment portfolio as at 31 December 2017, 2016 and 2015, respectively, related to loans, deposits with credit institutions, investments in partnerships in investment pools and derivative assets. Within debt securities of £95 billion (2016: £93 billion; 2015: £85 billion) as at 31 December 2017, 64 per cent (2016: 66 per cent; 2015: 68 per cent) was consisted of corporate debt securities.

Interest and dividend income increased by £164 million from £6,019 million in 2016 to £6,183 million in 2017, and decreased by £411 million from £6,430 million in 2015 to £6,019 million in 2016.

The decrease in investment appreciation and other investment return of £7,675 million from £16,076 million in 2016 to £8,401 million in 2017 principally reflects more significant gains on bonds and equities in 2016 compared with 2017. The increase in investment appreciation and other investment return of £18,099 million from a loss of £2,023 million in 2015 to a gain of £16,076 million in 2016 principally reflected gains on bonds following fall in UK Gilt yields in 2016.

Unallocated to a segment

Investment return for unallocated to a segment and intra-segment elimination was £77 million in 2017 compared with negative £113 million in 2016 and negative £18 million in 2015.

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

	Year ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Asia	**(18,269)**	(11,311)	(6,555)
US	**(31,205)**	(20,214)	(13,029)
UK and Europe	**(23,046)**	(27,841)	(10,072)
Unallocated to a segment	**(12)**		
Total	**(72,532)**	(59,366)	(29,656)

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

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

Total benefit and claims and movements in unallocated surplus of with-profits funds increased by £13,166 million in 2017 to a charge of £72,532 million compared with a charge of £59,366 million in

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2016 and a charge of £29,656 million in 2015. The amounts of this year-on-year charge attributable to each of the underlying reasons as stated above are shown below.

	Year ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Claims incurred, net of reinsurance	**(30,047)**	(25,730)	(23,763)
Increase in policyholder liabilities, net of reinsurance	**(39,613)**	(32,804)	(5,395)
Movement in unallocated surplus of with-profits funds	**(2,872)**	(832)	(498)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(72,532)**	(59,366)	(29,656)

The charge for benefits and claims and movements in unallocated surplus, net of reinsurance of £72,532 million (2016: £59,366 million; 2015: £29,656 million) shown in the table above includes the effect of accounting for investment contracts without discretionary participation features (as defined by IFRS 4) in accordance with IAS 39 to reflect the deposit nature of the arrangement.

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

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

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

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

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

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Asia

In 2017, benefits and claims and movements in unallocated surplus of with-profits funds totalled £18,269 million, representing an increase of £6,958 million compared with the charge of £11,311 million in 2016. In 2016, benefits and claims and movements in unallocated surplus of with-profits funds totalled £11,311 million, representing an increase of £4,756 million compared with the charge of £6,555 million in 2015.

The amounts of the year-on-year change attributable to each of the underlying reasons are shown below:

	Year ended 31 December		
	2017	2016	2015
	£m	£m	£m
Claims incurred, net of reinsurance	**(5,118)**	(4,530)	(4,151)
Increase in policyholder liabilities, net of reinsurance	**(12,048)**	(7,120)	(2,074)
Movement in unallocated surplus of with-profits funds	**(1,103)**	339	(330)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(18,269)**	(11,311)	(6,555)

The growth in the policyholder liabilities in Asia over the three-year period reflected the increase due to the combined growth of new business and the in-force books in the region.

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

United States

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

In 2017, the accounting charge for benefits and claims increased by £10,991 million to £31,205 million compared with £20,214 million in 2016. In 2016, the accounting charge for benefits and claims increased by £7,185 million to £20,214 million compared with £13,029 million in 2015.

The amounts of the year-on-year change attributable to each of the underlying reasons are shown below:

	Year ended 31 December		
	2017	2016	2015
	£m	£m	£m
Claims incurred, net of reinsurance	**(13,819)**	(11,026)	(9,688)
Increase in policyholder liabilities, net of reinsurance	**(17,386)**	(9,188)	(3,341)
Benefits and claims, net of reinsurance	**(31,205)**	(20,214)	(13,029)

The movements year-on-year in the claims incurred for the US operations as shown in the table above also included the effects of translating the US dollar results into pounds sterling at the average exchange rates for the relevant years.

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The charges in each year comprise amounts in respect of variable annuity and other business. The year on year movement is principally driven by the movement in the investment return on the assets backing the variable annuity separate account liabilities, which have increased in 2017 compared to 2016 and 2015 due to more favourable equity markets in the US.

UK and Europe

Overall, benefits and claims and the movement in unallocated surplus recorded in the income statement was a charge of £23,047 million in 2017 compared with a £27,841 million charge in 2016 and a £10,072 million charge in 2015. The year-on-year changes attributable to each of the underlying reasons are shown below, together with a further analysis of the amounts included in respect of the movements in policyholder liabilities by type of business:

	Year ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Claims incurred, net of reinsurance	**(11,101)**	(10,174)	(9,924)
Decrease/(increase) in policyholder liabilities, net of reinsurance			
SAIF	**349**	39	752
Shareholder-backed annuity business	**897**	(2,591)	301
Unit-linked and other non-participating business	**(1,479)**	(2,080)	171
With-profits (excluding SAIF)	**(9,944)**	(11,865)	(1,204)
	(10,177)	(16,498)	20
Movement in unallocated surplus of with-profits funds	**(1,769)**	(1,169)	(168)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(23,047)**	(27,841)	(10,072)

Claims incurred in the UK and Europe operations in 2017 were £11,101 million, compared with £10,174 million in 2016 and £9,924 million in 2015.

As has been explained above, the principal driver for variations in amounts allocated to the policyholders is changes to investment returns.

In aggregate, as a result of lower market returns in 2017 compared with 2016 there has been a corresponding impact on benefits and claims and movements in unallocated surplus of with-profits funds in the year, moving from a net charge of £27,841 million in 2016 to a net charge of £23,047 million in 2017. Conversely, the market returns in 2016 were higher compared with 2015, resulting in a movement from a net charge of £10,072 million in 2015 to a net charge of £27,841 million in 2016.

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

For shareholder-backed annuity business, following the withdrawal from selling non-profit retail annuities, which have higher capital requirements than other lines of businesses, net flows were negative in the year, thereby reducing policyholder liabilities. In addition, the decreases/(increases) in policyholder liabilities reflect the effect of altered investment yield reflected in the discount rate applied in the measurement of the liabilities and other altered assumptions where relevant, together with net flows into this line of business.

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

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

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

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

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

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

	Year ended 31 December		
	2017	**2016**	**2015**
	£m	**£m**	**£m**
Earned premiums, net of reinsurance[(i)]	**12,508**	9,261	6,507
Investment return	**9,985**	13,185	3,130
Other income	**35**	177	210
Acquisition costs and other expenditure	**(1,732)**	(1,288)	(1,318)
Share of profit from joint ventures	**106**	22	53
Tax charge	**(440)**	(739)	(148)
Total net income before benefit and claims and movement in unallocated surplus, net of reinsurance	**20,462**	20,618	8,434
Charges of:			
Claims incurred	**(8,449)**	(7,410)	(6,745)
Increase in policyholder liabilities[(i)]	**(10,011)**	(11,824)	(1,307)
Movement in unallocated surplus of with-profits funds	**(1,769)**	(1,169)	(168)
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance	**(20,229)**	(20,403)	(8,220)
Shareholders' profit after tax	**233**	215	214

Note

(i)

For the purposes of presentation in Prudential's consolidated financial information, references to UK and Europe's with-profits fund also include, for convenience, the amounts attaching to Prudential's UK Defined Charge Participating Sub-fund which includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 31 December 2007. Profits to shareholders emerge on a 'charges less expenses' basis and policyholders are entitled to 100 per cent of the investment earnings.

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

In 2017, the income statement of the UK component of the PAC with-profits funds was charged with a transfer of £1,769 million to the unallocated surplus. This transfer, together with a corresponding transfer in the unallocated surplus of the Asia with-profits funds and the effect of exchange rate movements, resulted in an increase in Prudential's unallocated surplus from £14.3 billion in 2016 to £17.0 billion in 2017. This movement reflected the net effect of changes in the value of assets, liabilities (incorporating policyholder bonuses and other elements of asset shares attributable to policyholders), and the shareholders' share of the cost of bonuses for 2017.

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

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

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

The factors that the PAC Board considers in setting bonus rates are described in more detail in the section headed 'With-profits products' in the section headed 'UK and Europe Basis of profits Bonus Rates' and are summarised in note C4.2(c) UK and Europe to the consolidated financial statements.

Unallocated to a segment

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

(d) Acquisition costs and other expenditure

	Year ended 31 December		
	2017	**2016***	**2015***
	£m	**£m**	**£m**
Asia	**(4,052)**	(3,685)	(2,778)
US	**(2,287)**	(1,912)	(2,332)
UK and Europe	**(3,379)**	(2,813)	(2,644)
Unallocated to a segment and intra-segment elimination	**(477)**	(438)	(454)
Total	**(10,195)**	(8,848)	(8,208)

* The 2016 and 2015 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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Total acquisition costs and other expenditure of £10,165 million in 2017 were 15 per cent higher than the £8,848 million incurred in 2016. Total acquisition costs and other expenditure of £8,848 million in 2016 were 8 per cent higher than the £8,208 million incurred in 2015.

Asia

Total acquisition costs and other expenditure for Asia in 2017 were £4,052 million compared with £3,684 million in 2016 and £2,778 million in 2015. The increase of £368 million from 2016 to 2017 and the increase of £906 million from 2015 to 2016 were due to increased acquisition costs and increases in other operating expenses as the business continues to expand. The increase of £368 million from 2016 to 2017 includes an exchange translation impact of £182 million. Excluding the effect of currency volatility, total acquisition costs and other expenditure increased by £186 million from 2016 to 2017.

United States

Total acquisition costs and other expenditure for the US of £2,257 million in 2017 represented an increase of £344 million over the amount of £1,913 million in 2016. The £1,913 million in 2016 represented a decrease of £419 million over the amount of £2,332 million in 2015.

The increase of £344 million from 2016 to 2017 includes an exchange translation impact of £97 million. Excluding the effect of currency volatility, total acquisition costs and other expenditure increased by £247 million from 2016 to 2017. Expenses fluctuate year on year due to the amortisation of deferred acquisition costs varying with the level of short-term fluctuations in investment returns.

UK and Europe

Total acquisition costs and other expenditure for UK and Europe increased by 20 per cent from £2,813 million in 2016 to £3,379 million in 2017. Total acquisition costs and other expenditure for UK and Europe increased by 6 per cent from £2,644 million in 2015 to £2,813 million in 2016.

The increase arose primarily from the increase in the charge for investment gains attributable to external unit-holders relating to funds managed on behalf of third parties which are consolidated but have no recourse to the Group, such charges increased by £234 million from £485 million in 2016 to £719 million in 2017. The 2017 other expenditure also includes a charge of £225 million provision (2016: £175 million) to increase the provision held for the cost of undertaking a review of past non-advised annuity sales practices and related potential redress.

Unallocated to a segment and intra-segment elimination

Other net expenditure represented a charge of £477 million in 2017, a charge of £438 million in 2016 and a charge of £454 million in 2015. The higher 2017 other net expenditure included restructuring costs of £103 million (2016: £38 million; 2015: £15 million) as the business invests for the future, including UK and Europe infrastructure.

Exchange Rate Information

Prudential publishes its consolidated financial statements in pounds sterling. References in this document to 'US dollars', 'US$', '$' or '¢' are to US currency, references to 'pounds sterling', '£', 'pounds', 'pence' or 'p' are to UK currency (there are 100 pence to each pound) and references to 'euro' or '€' are to the single currency adopted by the participating members of the European Union. The following table sets forth for each year the average of the noon buying rates on the last business day of each month of that year, as certified for customs purposes by the Federal Reserve Bank of New York, for pounds sterling

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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 31 December	Average rate
2013	1.56
2014	1.65
2015	1.53
2016	1.35
2017	1.29

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
September 2017	1.36	1.30
October 2017	1.33	1.31
November 2017	1.35	1.31
December 2017	1.35	1.33
January 2018	1.43	1.35
February 2018	1.42	1.38

On 16 March 2018 the latest practicable date prior to this filing, the noon buying rate was £1.00 = $1.39

EEV Basis, New Business Results and Free Surplus Generation

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

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

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

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

Additional Information on Liquidity and Capital Resources

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

Liquidity sources

The parent company including the central finance subsidiaries held cash and short-term investments of £2,264 million, £2,626 million and £2,173 million as at 31 December 2017, 2016 and 2015, respectively. The sources of cash in 2017 included dividends, loans and net cash amounts received from operating subsidiaries. Prudential received £1,788 million in net cash remittances from business units in 2017, compared with £1,718 million received in 2016 and £1,625 million received in 2015. These remittances primarily comprise dividends from business units and the shareholders' statutory transfer from the PAC long-term with-profits fund (UK Life Fund) relating to earlier bonus declarations.

Dividends, loans and net cash amounts received from subsidiaries

Under UK company law, dividends can only be paid if a company has distributable reserves sufficient to cover the dividend. In PAC, Prudential's largest operating subsidiary, distributable reserves arise from the emergence of profits from the company's long-term business. For the company's with-profits business the profits reflect the profit transfer to shareholders that occurs upon the declaration of bonuses to policyholders of with-profit products. Prudential's insurance and fund management subsidiaries' ability to pay dividends and loans to the parent company is restricted by various laws and regulations. Jackson is subject to state laws that limit the dividends payable to its parent company. Dividends in excess of these limitations generally require approval of the state insurance commissioner. The table below shows the dividends, loans and other net cash amounts received by Prudential from the principal operating subsidiaries for 2017 and 2016:

Dividends, loan and net cash amounts received in:	**2017**	**2016**
	£m	**£m**
Asia	**645**	516
US	**475**	420
UK and Europe*	**643**	590
Other UK (including Prudential Capital)*	**25**	192
Total	**1,788**	1,718

* The 2016 comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the consolidated financial statements.

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

Liquidity resources and requirements by operating business

M&G Prudential

The liquidity sources for M&G Prudential's life insurance business in UK and Europe comprise premiums, deposits and charges on policies, investment income, proceeds from the sale and maturity of investments, external borrowings and capital contributions from the parent company. The liquidity requirements comprise benefits and claims, operating expenses, interest on debt, purchases of investments. Amounts are distributed to the parent company after considering capital requirements.

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The liquidity requirements of M&G Prudential's life insurance businesses are regularly monitored to match anticipated cash inflows with cash requirements. Cash needs are forecast and projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying these projections are reviewed periodically. Adjustments are made periodically to the investment policies with respect to, among other things, the maturity and risk characteristics of the investment assets to reflect changes in the business' cash needs and also to reflect the changing competitive and economic environment.

The liquidity of M&G Prudential's insurance operations is affected by the payment of guaranteed benefits and terminal bonuses on maturing and surrendering policies. In addition, the non-cash bonus declaration to policyholders results in a cash transfer to shareholders' funds. A large proportion of Prudential's liabilities contains discretionary surrender values or surrender charges. In addition, pension annuity policies cannot be surrendered by the policyholder.

Further information on the Solvency II capital position of the M&G Prudential's insurance operations as at 31 December 2017 is provided in section II(b) of the Additional Unaudited Financial Information Section.

The principal liquidity source for M&G Prudential's asset management business (M&G) is fee income for managing retail, institutional and the internal investment funds of its life insurance operations. The principal liquidity requirements are for operating expenses and to comply with Client Assets Sourcebook (CASS) regulations. Amounts are distributed to the parent company after considering capital requirements. As at 31 December 2017, M&G's Capital requirements are driven by fixed operating expenses and met the relevant regulatory requirements.

US life insurance

The liquidity sources for Jackson are its cash, short-term investments and publicly traded bonds, premium income deposits received on certain annuity and institutional products, investment income, repurchase agreements, utilisation of a short-term borrowing facility with the Federal Home Loan Bank of Indianapolis and capital contributions from the parent company.

Liquidity requirements are principally for purchases of new investments and businesses, repayment of principal and interest on debt, payments of interest on surplus notes, funding of insurance product liabilities including payments for policy benefits, surrenders, maturities and new policy loans, and funding of expenses including payment of commissions, operating expenses and taxes. As at 31 December 2017, Jackson's outstanding surplus notes and bank debt included:

- US$87.4 million of bank loans from the Federal Home Loan Bank of Indianapolis, collateralised by mortgage-related securities and mortgage loans; and

- US$250 million of surplus notes maturing in 2027.

Significant increases in interest rates and disintermediation can create sudden increases in surrender and withdrawal requests by policyholders and contract holders. Other factors that are not directly related to interest rates can also give rise to disintermediation risk, including, but not limited to, changes in ratings from rating agencies, general policyholder concerns relating to the life insurance industry (eg the unexpected default of a large, unrelated life insurer) and competition from other products, including non-insurance products such as mutual funds, certificates of deposit and newly developed investment products. Most of the life insurance, annuity and institutional products Jackson offers permit the policyholder or contract holder to withdraw or borrow funds or surrender cash values. At 31 December 2017, over half of Jackson's fixed annuity reserves include policy restrictions such as surrender charges and market value adjustments to discourage early withdrawal of policy and contract funds.

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Jackson uses a variety of asset-liability management techniques to provide for the orderly provision of cash flow from investments and other sources as policies and contracts mature in accordance with their normal terms. Jackson's principal sources of liquidity to meet unexpected cash outflows associated with sudden and severe increases in surrenders and withdrawals are its portfolio of liquid assets and its net operating cash flows. As at 31 December 2017, the portfolio of cash, short-term investments and publicly traded securities and equities amounted to US$41.5 billion. Operating net cash inflows for Jackson in 2017 were US$5.0 billion.

As at 31 December 2017, the statutory capital and surplus of Jackson was US$3.9 billion, which was in excess of the requirements set out under Michigan insurance law. Jackson is also subject to risk-based capital guidelines that provide a method to measure the adjusted capital that a life insurance company should have for regulatory purposes, taking into account the risk characteristics of Jackson's investments and products. As at 31 December 2017, Jackson's total risk based capital ratio under the National Association of Insurance Commissioners' definition exceeded the Michigan standards.

Asia life insurance

The liquidity sources for Prudential's Asia life insurance businesses comprise premiums, deposits and charges on policies, investment income, proceeds from the sale and maturity of investments, external borrowings and capital contributions from the parent company. The liquidity requirements comprise benefits and claims, operating expenses, interest on debt and purchases of investments. Amounts are distributed to the parent company after considering capital requirements.

The liquidity requirements of Prudential's Asia life insurance businesses are regularly monitored to match anticipated cash inflows with cash requirements. Cash needs are forecast and projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying these projections are reviewed periodically. Adjustments are made periodically to the investment policies with respect to, among other things, the maturity and risk characteristics of the investment assets to reflect changes in the business cash needs and also to reflect the changing competitive and economic environment.

Contractual obligations

Contractual obligations of the Group with specified payment dates as at 31 December 2017 were as follows:

	Total	Less than 1 year	1 3 years	3 5 years	More than 5 years
			£m		
Policyholder liabilities(i)	542,221	29,853	61,035	59,191	392,142
Long-term debt(ii)	6,280	275			6,005
Other borrowings(ii)	5,507	2,074	557	60	2,816
Capital lease obligations	43	3	5	4	31
Operating lease obligations	515	113	164	120	118
Purchase obligations(iii)	4,029	4,029			
Obligations under funding, securities lending and sale and repurchase agreements	5,662	5,662			
Other long-term liabilities(iv)	10,092	9,456	337	97	202
Total	574,349	51,465	62,098	59,472	401,314

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	£m	£m
Reconciliation to consolidated statement of financial position:		
Total contractual obligations per above		574,349
Difference between policyholder liabilities per above (based on undiscounted cash flows) and total policyholder liabilities and unallocated surplus of with-profits funds per balance sheet:		
Total policyholder liabilities and unallocated surplus of with-profits funds per the consolidated statement of financial position	428,194	
Policyholder liabilities (undiscounted) per above	(542,221)	(114,027)
Other short-term/non-contractual obligations:		
Current tax liabilities	537	
Deferred tax liabilities	4,715	
Accruals, deferred income and other creditors (excluding capital and operating lease obligations and purchase obligations)	15,308	
Derivative liabilities	2,755	23,315
Purchase obligations not on the statement of financial position		(4,029)
Other items		(1,761)
Total liabilities per consolidated statement of financial position		477,847

Notes

(i)

Amounts shown in respect of policyholder liabilities represent estimated undiscounted cash flows for Prudential's life assurance contracts. In determining the projected payments, account has been taken of the contract features, in particular that the amount and timing of policyholder benefit payments reflect either surrender, death, or contract maturity. In addition, the undiscounted amounts shown include the expected payments based on assumed future investment returns on assets backing policyholder liabilities. The projected cash flows exclude the unallocated surplus of with-profits funds. As at 31 December 2017, on the IFRS basis of reporting, the unallocated surplus was £16,951 million (2016: £14,317 million). The unallocated surplus represents the excess of assets over liabilities, including policyholder 'asset share' liabilities, which reflect the amount payable under the 'grandfathered' realistic Peak 2 reporting regime of the PRA. Although accounted for as a liability, as permitted by IFRS 4, there is currently no expected payment date for the unallocated surplus.

(ii)

The amounts represent the contractual maturity of amounts of borrowings included in the consolidated statement of financial position (ie excludes future interest payments) as shown in note C6 to Prudential's consolidated financial statements. Long-term debt comprises the core structural borrowings of shareholder-financed operations and the £100 million 8.5 per cent undated subordinated guaranteed bonds of Scottish Amicable Finance plc. Other borrowings comprise operational borrowings attributable to shareholder-financed operations and borrowings attributable to with-profits operations but excluding the £100 million 8.5 per cent undated subordinated guaranteed bonds of Scottish Amicable Finance plc.

(iii)

Comprising of purchase obligations unfunded commitments for investments in limited partnerships of £414 million (2016: £465 million), commercial mortgage loans and other fixed maturities of £214 million (2016: £201 million), private equity and infrastructure funds held by the UK with-profits funds of

£3,225 million (2016: £2,269 million) and contractual obligations to purchase or develop investment properties of £176 million (2016: £458 million).

(iv) Amounts due in less than one year include amounts attributable to unit holders of consolidated unit trusts and similar funds of £8,889 million (2016: £8,687 million).

Group consolidated cash flows

The discussion that follows is based on the consolidated statement of cash flows prepared under IFRS and presented this Form 20-F.

Net cash inflows in 2017 were £734 million. This amount comprised inflows of £1,620 million from operating activities and inflows of £816 million from investing activities less outflows of £1,702 million from financing activities.

Net cash inflows in 2016 were £1,281 million. This amount comprised inflows of £2,201 million from operating activities less outflows of £549 million from investing activities less outflows of £371 million from financing activities.

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Net cash inflows in 2015 were £1,390 million. This amount comprised inflows of £2,533 million from operating activities less outflows of £469 million from investing activities less outflows of £674 million from financing activities.

The Group held cash and cash equivalents of £10,690 million at 31 December 2017 compared with £10,065 million and £7,782 million at 31 December 2016 and 2015, respectively.

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GROUP RISK FRAMEWORK

Risk Management

1. Introduction

2017 was, in many respects, a year of global geopolitical transition. Popular discontent was one of the driving factors, shifting the political landscape in many countries, in particular in the US and across Western Europe. The nature of technology risks evolved during the year, with high profile and untargeted attacks affecting companies around the world. Despite all this, financial markets appeared largely unperturbed during 2017 with low volatility and steady and broad global economic growth, and the first steps were taken toward monetary policy tightening in key economies.

As in previous years, we continue to maintain a sustained focus on managing prevailing market conditions and macroeconomic uncertainty arising from the global environment. Looking internally, in August 2017 we announced our intention to combine M&G and our UK life business to form M&G Prudential, allowing us better to leverage our scale and capabilities. Change inherently carries risk, but we will manage and minimise this appropriately in order to provide better outcomes for our customers.

Our results show that, even in times of unpredictability, we can generate value for our shareholders by taking selective exposure to risks that are rewarded commensurately and that can be quantified appropriately and managed. We retain risks within a clearly defined risk appetite, where we believe doing so contributes to value creation and the Group is able to withstand the impact of an adverse outcome. For our retained risks, we ensure that we have the necessary capabilities, expertise, processes and controls to manage the exposure appropriately.

Our Group Risk Framework and risk appetite have allowed us to control our risk exposure successfully throughout the year. Our governance, processes and controls enable us to deal with the uncertainty ahead in order to continue helping our customers achieve their long-term financial goals.

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

2. Risk governance, culture and our risk management cycle

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

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

a. Risk governance

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

i. Risk committees and governance structure

Our risk governance structure is led by the Group Risk Committee, supported by independent non-executives on risk committees of major subsidiaries. These committees monitor the

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development of the Group Risk Framework, which includes risk appetite, limits, and policies, as well as risk culture.

In addition to our risk committees, there are various executive risk forums to ensure risk issues are shared and considered across the Group. These are led by the Group Executive Risk Committee, an advisory committee to the Group Chief Risk Officer which is supported by a number of sub-committees, including security and information security where specialist skills and knowledge are required.

ii. Group Risk Framework

The Group Risk Framework has been developed to monitor and manage the risks to our business and is owned by the Board. The aggregate Group exposure to our key risk drivers is monitored and managed by the Group Risk function which is responsible for reviewing, assessing and reporting on the Group's risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

The Framework requires all our businesses and functions to establish processes for identifying, evaluating, managing and reporting of the key risks faced by the Group the 'Risk Management Cycle' (see below) is based on the concept of the 'three lines of defence', comprising risk taking and management, risk control and oversight, and independent assurance.

A major part of the Risk Management Cycle is the annual assessment of the Group's most material risks. These risks range from those associated with the economic, market, political and regulatory environment; those that we assume when writing our insurance products and by virtue of the investments we hold; and those that are inherent in our business model and its operations. This is used to inform risk reporting to the risk committees and the Board for the year.

The Group Risk Committee reviews the Group Risk Framework and recommends changes to our Board to ensure that it remains effective in identifying and managing the risks faced by the Group. A number of core risk policies and standards support the Framework to ensure that risks to the Group are identified, assessed, managed and reported. During 2017 we made a number of enhancements to our policies and processes. These included changes to our processes around new product approvals, management of our critical outsourcing arrangements and we increased oversight of model risk across the Group. A new framework was developed to support the monitoring and reporting of risks associated with material transformation programmes, and work continued over the year on the Group's risk culture.

iii. Risk appetite, limits and triggers

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

Group risk appetite is set with reference to economic and regulatory capital, liquidity and earnings volatility, as well as for our major risks, and is aimed at ensuring that we take an appropriate level of aggregate risk. It covers risks to shareholders, including those from participating and third-party business.

We have some appetite to take market and credit risk where it arises from profit-generating insurance activities, to the extent that it remains part of a balanced portfolio of sources of income

for shareholders and is compatible with a robust solvency position. We also have some appetite for retaining insurance risks in areas where we believe we have expertise and operational controls, and where we judge it to create more value to retain rather than transfer the risk. The extent of insurance risk that we are willing to hold is conditional on a balanced portfolio of income to shareholders and compatibility with a robust solvency position.

We have no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement or monitor appropriate controls to manage operational risks. Similarly, we have no appetite for liquidity risk, ie for any business to have insufficient resources to cover its outgoing cash flows, or for the Group as a whole to not meet cash flow requirements from its debt obligations under any plausible scenario.

Group limits operate within these expressions of risk appetite to constrain material risks, while triggers and indicators provide further constraint and ensure escalation. The Group Chief Risk Officer determines the action to be taken upon all breaches of Group limits which may include escalation to the Group Risk Committee or Board. Any decision on action taken by the Group Chief Risk Officer is reviewed at the subsequent Group Risk Committee meeting.

Earnings volatility:

The objectives of the aggregate risk limits seek to ensure that:

- The volatility of earnings is consistent with the expectations of stakeholders;
- The Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks; and
- Earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies.

The two measures used to monitor the volatility of earnings are IFRS operating profit and EEV operating profit, although IFRS and EEV total profits are also considered.

Liquidity:

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

Capital requirements:

The limits aim to ensure that:

- The Group meets its internal economic capital requirements;
- The Group achieves its desired target rating to meet its business objectives; and
- Supervisory intervention is avoided.

The two measures used at the Group level are Solvency II capital requirements and internal economic capital (ECap) requirements. In addition, capital requirements are monitored on local statutory bases.

The Group Risk Committee is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is supported by the Group Risk function, which uses submissions

from our local business

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units to calculate the Group's aggregated position (allowing for diversification effects between local business units) relative to the aggregate risk limits.

iv. Risk policies

These set out the specific requirements which cover the fundamental principles for risk management within the Group Risk Framework. Policies are designed to give some flexibility so that business users can determine how best to comply with policies based on their local expertise.

There are core risk policies for credit, market, insurance, liquidity and operational risks and a number of internal control policies covering internal model risk, underwriting, dealing controls and tax risk management. They form part of the Group Governance Manual, which was developed to make a key contribution to the sound system of internal control that we maintain in line with the UK Corporate Governance Code and the Hong Kong Code on Corporate Governance Practices. Group Head Office and business units must confirm on an annual basis that they have implemented the necessary controls to evidence compliance with the Group Governance Manual.

v. Risk standards

The Group-wide Operating Standards provide supporting detail to the higher level risk policies. In many cases they define the minimum requirements for compliance with Solvency II regulations which in some areas are highly prescriptive. The standards are more detailed than policies.

b. Our risk culture

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

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

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

During 2017 a risk culture assessment was performed across the Group. The assessment allowed us to compare the Group's risk culture against best practice behaviours, identify any areas which need improvement and provide high-level industry benchmarking and peer comparison. The Group Risk Committee also has a key role in providing advice to the Remuneration Committee on risk management considerations to be applied in respect of executive remuneration.

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

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c. The risk management cycle

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

i. Risk identification

Group-wide risk identification takes place throughout the year and includes processes such as our Own Risk and Solvency Assessment (ORSA) and the horizon-scanning performed as part of our emerging risk management process.

On an annual basis, a top-down identification of the Group's key risks is performed, which considers those risks that have the greatest potential to impact the Group's operating results and financial condition. A bottom-up process of risk identification is performed by the business units who identify, assess and document risks, with appropriate coordination and challenge from the risk functions.

The Group ORSA report pulls together the analysis performed by a number of risk and capital management processes, which are embedded across the Group, and provides quantitative and qualitative assessments of the Group's risk profile, risk management and solvency needs on a forward-looking basis. The scope of the report covers the full known risk universe of the Group.

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

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

Our emerging risk management process identifies potentially material risks which have a high degree of uncertainty around timing, magnitude and propensity to evolve. In 2017 we enhanced our Emerging Risk Framework to bring it closer to the Group's risk management activity. This included a redefinition of the relationship between emerging and emerged risks, enabling a consistent framework for evaluating and escalating sufficiently developed emerging risks for risk management activity. The Group holds emerging risk sessions over the year to identify emerging risks which includes input from local subject matter and industry experts. We maintain contacts with thought leaders and peers to benchmark and refine our process.

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

ii. Risk measurement and assessment

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

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iii. Risk management and control

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

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

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

The methods and risk management tools we employ to mitigate each of our major categories of risks are detailed in section 4 below.

iv. Risk monitoring and reporting

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

3. Summary risks

The components of our business model give rise to risks of varying nature across the Group which can broadly be categorised as those which arise as a result of our business operations; those risks arising from our investments; those which arise from the nature of our products; and those broad risks which apply to us because of the global environment in which we operate. These risks, where they materialise, may have a financial impact on the Group, and could also impact on the performance of our products or the services we provide our customers and distributors, which gives rise to potential risks to our brand, reputation and have conduct risk implications. These risks are summarised below. We have indicated whether these risks are considered material at the level of the Group or our business units. Our disclosures covering risk factors can be found at the end of this document.

'Macro' risks

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

- **Global economic conditions.** Changes in global economic conditions can impact us directly; for example by leading to poor returns on our investments and increasing the cost of promises (guarantees) we have made to our customers. Our fund investment performance may also be impacted, which is a fundamental part of our business in providing appropriate returns for our customers and shareholders. Changes in economic conditions can also have an indirect impact on us; for example economic pressures could lead to decreased savings, reducing the propensity for people to buy our products. Global economic conditions may also impact on regulatory risk for the Group by changing prevailing political attitudes towards regulation. We consider this to be a risk which is material at the level of the Group.

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

Digital disruption. The emergence of advanced technologies such as artificial intelligence and block chain is providing an impetus for companies to rethink their existing operating models and how they interact with their customers. We consider digital disruption from both an external and internal view. The external view considers the rise of new technologies and how this may impact on our industry and our competitiveness within it, while the internal view considers the risks associated with our own internal developments in meeting digital change challenges and opportunities. While we are embracing such opportunities, we are also closely monitoring any risks which arise.

Risks from our investments

Credit risk
Is the potential for reduced value of our investments due to the uncertainty around investment returns arising from the potential for defaults of our investment counterparties. Invested credit risk arises from our asset portfolio. We increase sector focus where necessary.

The assets backing the M&G Prudential and Jackson annuity businesses means credit risk is considered a material risk for these business units in particular.

Market risk
Is the potential for reduced value of our investments resulting from the volatility of asset prices as driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices. Certain market risks are considered more material for specific business units.

Risks from our products

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

The insurance risks that we are exposed to by virtue of our products include **longevity risk** (policyholders living longer than expected); **mortality risk** (policyholders with life protection dying); **morbidity risk** (policyholders with health protection becoming ill) and **persistency risk** (customers lapsing their policies, and a type of policyholder behaviour risk).

From our health protection products, increases in the costs of claims (including the level of medical expenses) increasing over and above price inflation (claim inflation) is another risk.

Risks from our business operations

Operational risks
The complexity of our Group and activities means we face a challenging operating environment. This results from the high volume of transactions we process; product and investment portfolios; our people, processes and IT systems; and the extensive regulations under which we operate.

We also face operational risks through business transformation; introducing new products; new technologies; engaging in third party relationships; and entering into new markets and geographies. Implementing our business strategy requires interconnected change initiatives across the Group. The pace of change further adds to the complexity of our operational risk profile.

Without an effective operational risk framework, such risks could cause significant disruption our systems and operations, resulting in financial loss and/or reputational damage. We consider operational risk to be material at the level of the Group.

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Risks from our investments

In our Asia business, our main market risks arise from the value of fees from our fee-earning products. In the US, Jackson's fixed and variable annuity books are exposed to a variety of market risks due to the assets backing these policies.

In the UK, exposure arises from the valuation of the proportion of the with-profits fund's future profits which is transferred to the shareholders (future transfers), which is dependent on equity, property and bond values.

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

Liquidity risk
Is the risk of not having sufficient liquid assets to meet our obligations as they fall due, and incorporates the risk arising from funds composed of illiquid assets. It results from a mismatch between the liquidity profile of assets and liabilities. We consider this a risk which is material at the level of the Group.

Risks from our products

The processes that determine the price of our products and reporting the results of our long-term business operations require us to make a number of assumptions. Where experience deviates from these assumptions our profitability may be impacted.

Across our business units, some insurance risks are more material than others.

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

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

At Jackson, the most material insurance risk is policyholder behaviour risk, including persistency. This impacts the profitability of the variable annuity business and influenced by market performance and the value of policy guarantees.

Risks from our business operations

Information security risk is a significant consideration within operational risk, including both the continuously evolving risk of malicious attack on our systems as well as risks relating to data security and integrity and network disruption. The size of Prudential's IT infrastructure and network, our move toward digitalisation and the increasing number of high profile cyber security incidents across industries means that this risk will continue to be an area of high focus and is one considered to be material to the Group.

Regulatory risk
We also operate under the ever-evolving requirements set out by diverse regulatory and legal and tax regimes, as well as utilising a significant number of third parties to distribute products and to support business operations; all of which adds to the complexity of our operations.

The number of regulatory changes under way across Asia, in particular those focusing on consumer protection means that regulatory change in the region is considered a key risk.

Both Jackson and M&G Prudential operate in highly regulated markets. Regulatory reforms can have a material impact on our businesses, and regulatory focus continues to be high.

4. Further risk information

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

4.1 Risks from our investments

a. Market risk

The main drivers of market risk in the Group are:

- Investment risk (including equity and property risk);
- Interest rate risk; and

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- Given the geographical diversity of our business, foreign exchange risk.

With respect to investment risk, equity and property risk arises from our holdings of equity and property investments, the prices of which can change depending on market conditions.

The valuation of our assets (particularly the bonds that we invest in) and liabilities are also dependent on market interest rates and exposes us to the risk of those moving in a way that is detrimental for us.

Given our global business, we earn our profits and have assets and liabilities in various currencies. The translation of those into our reporting currency exposes us to movements in foreign exchange rates.

Our main investment risk exposure arises from the portion of the profits from the M&G Prudential with-profits fund to which we are entitled to receive; the value of the future fees from our fee-earning products in our Asia business; and from the asset returns backing Jackson's variable annuities business.

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

The methods that we use to manage and mitigate our market risks include the following:

- Our market risk policy;
- Risk appetite statements, limits and triggers that we have in place;
- The monitoring and oversight of market risks through the regular reporting of management information;
- Our asset and liability management programmes;
- Use of derivative programmes, including, for example, interest rate swaps, options and hybrid options for interest rate risk;
- Regular deep dive assessments; and
- Use of currency hedging.

Investment risk

(Audited)

In the UK business, our main investment risk arises from the assets held in the with-profits funds. Although this is mainly held by our policyholders, a proportion of the funds' declared bonuses and policyholder net investment gains is shared with shareholders and so our investment exposure relates to the future performance of that proportion (future transfers).

This investment risk is driven mainly by equities in the funds, although there is some risk associated with other investments such as property and bonds. Some hedging to protect against a reduction in the value of these future transfers against falls in equity prices is performed outside the funds using derivatives. The with-profits funds' large Solvency II own funds estimated at £9.6 billion as at 31 December 2017 (31 December 2016: £8.4 billion) helps to protect against market fluctuations and helps the funds to maintain appropriate solvency levels. The with-profits funds' Solvency II own funds are protected partially against falls in equity markets through an active hedging programme within the fund.

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

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

Interest rate risk

(Audited)

While long-term interest rates in advanced economies have increased broadly since mid-2016 and indications are for further gradual tightening of monetary policy and the start of balance sheet normalisation by central banks, they remain close to historical lows. Some products that we offer are sensitive to movements in interest rates. We have already taken a number of actions to reduce the risk to the in-force business, as well as re-pricing and restructuring new business offerings in response to these historically low interest rates. Nevertheless, we still retain some sensitivity to interest rate movements.

Interest rate risk arises in M&G Prudential's insurance business from the need to match cash payments to meet annuity obligations with the cash we receive from our investments. To minimise the impact on our profit, we aim to match the duration (a measure of interest rate sensitivity) of assets and liabilities as closely as possible and the position is monitored regularly. Under the Solvency II regulatory regime, additional interest rate risk results from the way the balance sheet is constructed, such as the requirement for us to include a risk margin. The UK business assesses on a continual basis the need for any derivatives in managing its interest rate sensitivity. The with-profits business is exposed to interest rate risk because of underlying guarantees in some of its products. Such risk is borne largely by the with-profits fund itself but shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

In Asia, our exposure to interest rate risk arises from the guarantees of some non unit-linked investment products. This exposure exists because it may not be possible to hold assets which will provide cash payments to us which match exactly those payments we in turn need to make to policyholders this is known as an asset and liability mismatch and although it is small and managed appropriately, it cannot be eliminated.

Jackson is exposed to interest rate risk in its fixed, fixed index and variable annuity books. Movements in interest rates can impact on the cost of guarantees in these products; in particular the cost of guarantees to us may increase when interest rates fall. We monitor the level of sales of variable annuity products with guaranteed living benefits actively, and together with the risk limits we have in place this helps us to ensure that we are comfortable with the interest rate and market risks we incur as a result. The Jackson hedging programme includes hybrid derivatives to provide some protection from a combined fall in interest rates and equity markets since Jackson is exposed to the combination of these market movements.

Foreign exchange risk

(Audited)

The geographical diversity of our businesses means that we have some exposure to the risk of exchange rate fluctuations. Our operations in the US and Asia, which represent a large proportion of our operating profit and shareholders' funds, generally write policies and invest in assets in local currencies. Although

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this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in our Group financial statements when results are reported in UK sterling.

We retain revenues locally to support the growth of our business and capital is held in the local currency of the business to meet local regulatory and market requirements. We accept the foreign exchange risk this can produce when reporting our Group balance sheet and income statement. In cases where a surplus arises in an overseas operation which is to be used to support Group capital, or where a significant cash payment is due from an overseas subsidiary to the Group, this foreign exchange exposure is hedged where we believe it is favourable economically to do so. Generally, we do not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside of the countries in which we operate, but we do have some appetite for this on fee income and on non-sterling investments within the with-profits fund. Where foreign exchange risk arises outside our appetite, currency borrowings, swaps and other derivatives are used to manage our exposure.

b. Credit risk

We invest in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments we need to make to policyholders. We also enter into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, we are exposed to credit risk and counterparty risk across our business.

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

We use a number of risk management tools to manage and mitigate this credit risk, including the following:

- Our credit risk policy;
- Risk appetite statements and limits that we have defined on issuers, and counterparties;
- Collateral arrangements we have in place for derivative, secured lending reverse repo and reinsurance transactions;
- The Group Credit Risk Committee's oversight of credit and counterparty credit risk and sector and/or name-specific reviews. In 2017 it has conducted sector reviews in the Asia sovereign sector, the UK banking sector, the US retail property sector, and continues to review the developments around central clearing;
- Regular deep dive assessments; and
- Close monitoring or restrictions on investments that may be of concern.

Debt and loan portfolio

(Audited)

Our UK business is exposed mainly to credit risk on fixed income assets in the shareholder-backed portfolio. At 31 December 2017, this portfolio contained fixed income assets worth £35.3 billion. Credit risk arising from a further £57.4 billion of fixed income assets is borne largely by the with-profits fund, to which the shareholder is not exposed directly although under extreme circumstances shareholder support may be required if the fund is unable to meet payments as they fall due.

Credit risk also arises from the debt portfolio in our Asia business, the value of which was £41.0 billion at 31 December 2017. The majority (68 per cent) of the portfolio is in unit-linked and with-profits funds

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and so exposure of the shareholder to this component is minimal. The remaining 32 per cent of the debt portfolio is held to back the shareholder business.

Credit risk also arises in the general account of the Jackson business, where £35.4 billion of fixed income assets are held to support shareholder liabilities including those from our fixed annuities, fixed index annuities and life insurance products.

The shareholder-owned debt and loan portfolio of the Group's other operations was £2.3 billion as at 31 December 2017.

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

Group sovereign debt

(Audited)

We also invest in bonds issued by national governments. This sovereign debt represented 19 per cent or £16.5 billion of the shareholder debt portfolio as at 31 December 2017 (31 December 2016: 19 per cent or £17.1 billion). 5 per cent of this was rated AAA and 90 per cent was considered investment grade (31 December 2016: 92 per cent investment grade).

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

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 31 December 2017 are given in Note C3.2(f) of the Group's IFRS financial statements.

Bank debt exposure and counterparty credit risk

(Audited)

Our exposure to banks is a key part of our core investment business, as well as being important for the hedging and other activities we undertake to manage our various financial risks. Given the importance of our relationship with our banks, exposure to the sector is considered a material risk for the Group with an appropriate level of management information provided to the Group's risk committees and the Board.

The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 31 December 2017 are given in Note C3.2(f) of the Group's IFRS financial statements.

Our exposure to derivative counterparty and reinsurance counterparty credit risk is managed using an array of risk management tools, including a comprehensive system of limits.

Where appropriate, we reduce our exposure, buy credit protection or use additional collateral arrangements to manage our levels of counterparty credit risk.

At 31 December 2017, shareholder exposures by rating[1] and sector are shown below:

- 95 per cent of the shareholder portfolio is investment grade rated. In particular, 69 per cent of the portfolio is rated A and above; and

- The Group's shareholder portfolio is well diversified: no individual sector makes up more than 10 per cent of the total portfolio (excluding the financial and sovereign sectors).

c. Liquidity risk

Our liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due. This incorporates the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may

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impact on market conditions and valuation of assets in a more uncertain way than for other risks like interest rate or credit risk. It may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or redemption requests are made against Prudential external funds.

We have significant internal sources of liquidity, which are sufficient to meet all of our expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external sources of funding. In total, the Group has £2.6 billion of undrawn committed facilities that we can make use of, expiring in 2022. We have access to further liquidity by way of the debt capital markets, and also have in place an extensive commercial paper programme and have maintained a consistent presence as an issuer in this market for the last decade.

Liquidity uses and sources are assessed at a Group and business unit level under both base case and stressed assumptions. We calculate a Liquidity Coverage Ratio (LCR) under stress scenarios as one measure of our liquidity risk, and this ratio and the liquidity resources available to us are monitored regularly and are assessed to be sufficient.

Our risk management and mitigation of liquidity risk include:

- Our liquidity risk policy;
- The risk appetite statements, limits and triggers that we have in place;
- The monitoring of liquidity risk we perform through regular management information to committees and the Board;
- Our Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as gap analysis of our liquidity risks and the adequacy of our available liquidity resources under normal and stressed conditions;
- Regular stress testing;
- Our established contingency plans and identified sources of liquidity;
- Our ability to access the money and debt capital markets;
- Regular deep dive assessments; and
- The access we have to external sources of finance through committed credit facilities.

4.2 Risks from our products

a. Insurance risk

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

The principal drivers of the Group's insurance risks are persistency and morbidity risk in the Asia business; longevity risk in the UK legacy business of M&G Prudential; and policyholder behaviour risks in Jackson.

We manage and mitigate our insurance risk using the following:

- Our insurance and underwriting risk policies;
- The risk appetite statements, limits and triggers we have in place;

- Using longevity, morbidity and persistency assumptions that reflect recent experience and expectation of future trends, and industry data and expert judgement where appropriate;
- Using reinsurance to mitigate longevity and morbidity risks;
- Ensuring appropriate medical underwriting when policies are issued and appropriate claims management practices when claims are received in order to mitigate morbidity risk;
- Maintaining the quality of our sales processes and using initiatives to increase customer retention in order to mitigate persistency risk;
- Using product re-pricing and other claims management initiatives in order to mitigate medical expense inflation risk; and
- Regular deep dive assessments.

Longevity risk is an important element of our insurance risks for which we need to hold a large amount of capital under Solvency II regulations. Longevity reinsurance is a key tool for us in managing our risk. The enhanced pensions freedoms introduced in the UK during 2015 reduced the demand for retail annuities greatly and further liberalisation is anticipated. Although we have withdrawn from selling new annuity business, given our significant annuity portfolio the assumptions we make about future rates of improvement in mortality rates remain key to the measurement of our insurance liabilities and to our assessment of any reinsurance transactions.

We continue to conduct research into longevity risk using both experience from our annuity portfolio and industry data. Although the general consensus in recent years is that people are living longer, there is considerable volatility in year-on-year longevity experience, which is why we need expert judgement in setting our longevity basis.

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

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

Our persistency assumptions reflect similarly a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. Persistency risk is mitigated by appropriate training and sales processes and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, we make allowance for the relationship (either assumed or observed historically) between persistency and investment returns and account for the resulting additional risk. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products. The effect of persistency on our financial results can vary but depends mostly on the value of the product features and market conditions.

4.3 Risks from our business operations

a. Non-financial risks

In the course of doing business, the Group is exposed to non-financial risks arising from our operations, the business environment and our strategy. Our main risks across these areas are detailed below.

We define operational risk as the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel or systems, or from external events. This includes employee error, model error, system failures, fraud or some other event which disrupts business processes. Processes are established for activities across the scope of our business, including operational activity, regulatory compliance, and those supporting environmental, social and governance (ESG) activities among others, any of which can expose us to operational risks.

We process a large volume of complex transactions across a number of diverse products, and are subject to a high number of varying legal, regulatory and tax regimes. We also have a number of important third-party relationships that provide the distribution and processing of our products, both as market counterparties and as outsourcing partners. M&G Prudential outsources several operations, including a significant part of its back office, customer-facing functions and a number of IT functions. These third party arrangements help us to provide a high level and cost-effective service to our customers, but they also make us reliant on the operational performance of our outsourcing partners.

The performance of our core business activities places reliance on the IT infrastructure that supports day-to-day transaction processing. Our IT environment must also be secure and we address an increasing cyber risk threat as our digital footprint increases see separate Cyber risk section below. The risk that our IT infrastructure does not meet these requirements is a key area of focus for us, particularly the risk that legacy infrastructure supporting core activities/processes affects business continuity or impacts on business growth.

Operational challenges also exist in keeping pace with regulatory changes. This requires implementing processes to ensure we are, and remain, compliant on an ongoing basis, including regular monitoring and reporting. The high rate of global regulatory change, in an already complex regulatory landscape, increases the risk of non-compliance due to a failure to identify, interpret correctly, implement and/or monitor regulatory compliance. See Global regulatory and political risk section below. Legislative developments over recent years, together with enhanced regulatory oversight and increased capability to issue sanctions, have resulted in a complex regulatory environment that may lead to breaches of varying magnitude if the Group's business-as-usual operations are not compliant. As well as prudential regulation, we focus on conduct regulation, including those related to sales practice and anti-money laundering, bribery and corruption. We have a particular focus on regulations related to the latter in newer/emerging markets.

The business environment we operate in has become increasingly complex over the years. The political, environmental, societal, legal and economic landscape is highly dynamic and uncertain. Changes and developments on the horizon may result in emerging risks to us which are monitored under our Emerging Risk Framework.

The Group maintains active engagement with our shareholders, governments, policymakers and regulators in our key markets, as well as with international institutions. This introduces expectations for the Group to act and respond to environmental, social and governance (ESG) matters in a certain manner. The perception that our key stakeholders have of us and our businesses is crucial in forming and maintaining a robust brand and reputation. As such, the Group's operational risk framework explicitly incorporates ESG as a component of our social and environmental responsibility, brand management and external communications within our framework. This is further strengthened by factoring considerations for reputational impacts when the materiality of operational risks are assessed.

The climate risk landscape continues to evolve and is moving up the agenda of many regulators, governments, non-governmental organisations and investors. Examples of this include the US Department of Labor's decision to change its guidance to pension fund fiduciaries to allow them to factor ESG issues into investment decisions; Hong Kong Stock Exchange listing rules requiring listed companies to provide a high-level discussion of ESG approaches and activities in external disclosures, and the Financial Stability Board's (FSB) Task Force for Climate-related Financial Disclosures.

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The increased regulatory focus on environmental issues not only reflects existing commitments, for example in the UK under the 2008 Climate Change Act, but also a heightened societal awareness of climate change as a pressing global concern. Regulatory and stakeholder interest in environmental matters is expected to increase as climate change moves higher up governmental agendas. This increase in focus creates a number of potential near term risks. These include:

- Investment risk in the form of 'transition risk'. This is the risk that an abrupt, unexpected tightening of carbon emission policies lead to a disorderly re-pricing of carbon-intensive assets;

- Liability risk, if the Group is unable to demonstrate sufficiently that we have acted to mitigate our exposure to climate change risk; and

- Reputational risks, where the Group's actions could affect external perceptions of our brand and corporate citizenship.

The Group has established a Group-wide Responsible Investment Advisory Committee with designated responsibility to oversee Prudential's responsible investment activities as both asset owners and asset managers.

Physical impacts of climate change could also arise, driven by specific climate-related events such as natural disasters. These impacts are mitigated through our crisis management and disaster recovery plans.

Strategic risk requires a forward-looking approach to risk management. A key part of our approach are the risk assessments performed as part of the Group's annual strategic planning process, which supports the identification of potential future threats and the initiatives needed to address them, as well as competitive opportunities. We also assess the impact on the Group's businesses and our risk profile to ensure that strategic initiatives are within the Group's overall risk appetite.

Implementation of the Group's strategy and the need to comply with emerging regulation has resulted in a significant portfolio of transformation and change initiatives, which may further increase in the future. In particular the intention to demerge the UK and Europe business from the rest of the Group will result in a substantial change programme which will need to be managed at the same time that other material transformation programmes are being delivered. The scale and the complexity of the transformation programmes could impact business operations and customers, and has the potential for reputational damage if these programmes fail to deliver their objectives. Implementing further strategic initiatives may amplify these risks.

Other significant change initiatives are occurring across the Group. The volume, scale and complexity of these programmes increases the likelihood and potential impact of risks associated with:

- Dependencies between multiple projects;

- The organisational ability to absorb change being exceeded;

- Unrealised business objectives/benefits; and

- Failures in project design and execution.

The risks detailed above form key elements of the Group's operational risk profile. In order to effectively identify, assess, manage, control and report on all operational risks across the business, a Group-wide operational risk framework is in place. The key components of the framework are:

- Application of a risk and control assessment (RCA) process, where operational risk exposures are identified and assessed as part of a periodical cycle. The RCA process takes into account a range of internal and external factors, including an assessment of the control environment, to determine the business's most significant risk exposures on a prospective basis;

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- An internal incident capture process, which identifies, quantifies and monitors remediation conducted through application of action plans for risk events that have occurred across the business;
- A scenario analysis process for the quantification of extreme, yet plausible manifestations of key operational risks across the business on a forward looking basis. This is carried out at least annually and supports external and internal capital requirements as well as informing risk activity across the business; and
- An operational risk appetite framework that articulates the level of operational risk exposure the business is willing to tolerate and sets out escalation processes for breaches of appetite.

Outputs from these processes and activities performed by individual business units are monitored by the Group Risk function, who provide an aggregated view of risk profile across the business to the Group Risk Committee and Board.

These core framework components are embedded across the Group via the Group Operational Risk Policy and Standards documents, which sets out the key principles and minimum standards for the management of operational risk across the Group.

The Group operational risk policy, standards and operational risk appetite framework sit alongside other risk policies and standards that individually engage with key operational risks, including outsourcing and third-party supply, business continuity, technology and data, and operations processes.

These policies and standards include subject matter expert-led processes that are designed to identify, assess, manage and control operational risks, including the application of:

- A transformation risk framework that assesses, manages and reports on the end-to-end transformation lifecycle, project prioritisation and the risks, interdependencies and possible conflicts arising from a large portfolio of transformation activities;
- Internal and external review of cyber security capability;
- Regular updating and testing of elements of disaster-recovery plans and the Critical Incident Procedure process;
- Group and business unit-level compliance oversight and testing in respect of adherence with in-force regulations;
- Regulatory change teams in place assist the business in proactively adapting and complying with regulatory developments;
- A framework in place for emerging risk identification and analysis in order to capture, monitor and allow us to prepare for operational risks that may crystallise beyond the short-term horizon;
- Corporate insurance programmes to limit the financial impact of operational risks; and
- Reviews of key operational risks and challenges within Group and business unit business plans.

These activities are fundamental in maintaining an effective system of internal control, and as such outputs from these also inform core RCA, incident capture and scenario analysis processes and reporting on operational risk. Furthermore, they also ensure that operational risk considerations are embedded in key business decision-making, including material business approvals and in setting and challenging the Group's strategy.

b. Global regulatory and political risk

Our risk management and mitigation of regulatory and political risk includes the following:

Risk Assessment of the Business Plan which includes consideration of current strategies;

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- Close monitoring and assessment of our business environment and strategic risks;
- The consideration of risk themes in strategic decisions; and
- Ongoing engagement with national regulators, government policy teams and international standard setters.

Recent shifts in the focus of some governments toward more protectionist or restrictive economic and trade policies could impact on the degree and nature of regulatory changes and Prudential's competitive position in some geographic markets. This could take effect, for example, through increased friction in cross-border trade, capital controls or measures favouring local enterprises such as changes to the maximum level of non-domestic ownership by foreign companies. We continue to monitor these developments at a national and global level and these considerations form part of our ongoing engagement with government policy teams and regulators.

On 29 March 2017 the UK submitted formal notification of its intention to withdraw from the EU. In December 2017, agreement was reached between the UK and EU to progress negotiations onto transitional arrangements and the future trading relationship. The outcome of negotiations remains highly uncertain. If no formal withdrawal agreement is reached then it is expected the UK's membership of the EU will terminate automatically two years after the submission of the notification.

The ongoing uncertainty during the remainder of the negotiation period and the potential for a disorderly exit from the EU by the UK without a negotiated agreement may increase volatility in the markets where we operate, creating the potential for a general downturn in economic activity and for falls in interest rates in some jurisdictions due to easing of monetary policy and investor sentiment.

As a Group, our diversification by geography, currency, product and distribution should reduce some of the potential impact. We have UK-domiciled operations including M&G Prudential, and due to the geographical location of both its businesses and its customers, its insurance and the fund management operations have most potential to be affected by the UK's exit. The extent of the impact will depend in part on the nature of the arrangements that are put in place between the UK and the EU. Contingency plans were developed ahead of the referendum by business units and operations that may be impacted immediately by a vote to withdraw the UK from the EU, and these plans have been enacted since the referendum result. We have since also undertaken significant work to ensure that our business, and in particular our customer base, is not unduly affected by the decision of the UK to exit from the EU.

The UK's decision to leave the EU has introduced uncertainty to the extent of future applicability of the Solvency II regime in the UK. In October 2017, the Treasury Committee published its report on the Solvency II Directive and the UK Insurance Industry, which highlighted the need for a strategy, post-UK exit, to foster innovation, competition and competitiveness for the benefit of UK consumers. In late 2016 the European Commission began a review of some aspects of the Solvency II legislation, with a particular focus on the Solvency Capital Requirement calculated using the standard formula, which is expected to run until 2021.

National and regional efforts to curb systemic risk and promote financial stability are also underway in certain jurisdictions in which Prudential operates, including the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US, the work of the Financial Stability Board (FSB) on Global Systemically Important Insurers (G-SIIs) and the Insurance Capital Standard being developed by the International Association of Insurance Supervisors (IAIS). There are also a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way Prudential is supervised. These include addressing Financial Conduct Authority (FCA) reviews, ongoing engagement with the Prudential Regulation Authority (PRA), and the work of the Financial Stability Board (FSB) and standard-setting institutions such as the IAIS. Decisions taken by regulators, including those related to solvency requirements, corporate or governance structures, capital allocation and risk management may have an impact on our business.

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The IAIS's G-SII regime forms additional compliance considerations for us. Groups designated as G-SIIs are subject to additional regulatory requirements, including enhanced group-wide supervision, effective resolution planning, development of a Systemic Risk Management Plan, a Recovery Plan and a Liquidity Risk Management Plan. The FSB did not publish a new list of G-SIIs in 2017, however the policy measures set out in the FSB's 2016 communication on G-SIIs continue to apply to the Group. Prudential is monitoring the development and potential impact of the policy measures and is continuing to engage with the PRA on the implications of such measures and Prudential's designation as a G-SII. The IAIS has launched a public interim consultation on an activities-based approach to systemic risk. Following the feedback from this, a second consultation with proposals for policy measures is due to be launched in 2018. Any changes to the designation methodology are expected to be implemented in 2019.

We continue to engage with the IAIS on developments in capital requirements for groups with G-SII designation. The regime introduces capital requirements in the form of a Higher Loss Absorption (HLA) requirement. This requirement was initially intended to come into force in 2019 but has been postponed until 2022. The HLA is also now intended to be based on the Insurance Capital Standard, which is being developed by the IAIS as the capital requirements under its Common Framework (ComFrame). This framework is focused on the supervision of Internationally Active Insurance Groups (IAIGs) and will establish a set of common principles and standards designed to assist regulators in addressing risks that arise from insurance groups with operations in multiple jurisdictions. As part of this, work is underway to develop a global Insurance Capital Standard (ICS) that is intended to apply to Internationally Active Insurance Groups.

The IAIS has announced that the implementation of ICS will be conducted in two phases a five-year monitoring phase followed by an implementation phase. During the monitoring phase, IAIGs will be required to report on ICS to the group-wide supervisor on a confidential basis, although these results will not be used as a basis to trigger supervisory action.

The IAIS's Insurance Core Principles, which provide a globally-accepted framework for the supervision of the insurance sector and ComFrame evolution, are expected to create continued development in both prudential and conduct regulations over the next two to three years.

In the US, some parts of the Department of Labor (DoL) rule introducing fiduciary obligations for distributors of investment products, which may reshape dramatically the distribution of retirement products, became effective on 9 June 2017. This included those provisions on impartial conduct standards, although other provisions of the rule have now been delayed until 1 July 2019. Jackson has introduced fee-based variable annuity products in response to the introduction of the rule, and we anticipate that the business's strong relationships with distributors, history of product innovation and efficient operations should further mitigate any impacts.

The US National Association of Insurance Commissioners (NAIC) is continuing its industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and risk management. Following two industry quantitative impact studies, proposed changes to the current framework have been released by the NAIC for comment from industry and other interested parties. Jackson continues to be engaged in the consultation and testing process. The proposed changes are expected to be effective from 2019 at the earliest. In December 2017, the Tax Cuts and Jobs Act was signed into law in the US. Some uncertainty exists on the implications of the tax reforms on the NAIC's proposals.

A degree of uncertainty as to the timing, status and final scope of these key US reforms exists. Our preparations to manage the impact of these reforms will continue while we await further clarification.

In May 2017, the International Accounting Standards Board (IASB) published IFRS 17 which will introduce fundamental changes to the statutory reporting of insurance entities that prepare accounts according to IFRS from 2021. The Group is reviewing the complex requirements of the standard and is

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considering its potential impact. This is expected to, among other things, include altering the timing of IFRS profit recognition, and the implementation of the standard is likely to require changes to the Group's IT, actuarial and finance systems.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New local capital rules and requirements could be introduced in these and other regulatory regimes that challenge legal or ownership structures, current sales practices, or could be applied to sales made prior to their introduction retrospectively, which could have a negative impact on Prudential's business or reported results.

c. Cyber risk

Cyber risk remains an area of heightened focus after a number of recent high profile attacks and data losses. The growing maturity and industrialisation of cyber-criminal capability, together with an increasing level of understanding of complex financial transactions by criminal groups, are two reasons why risks to the financial services industry are increasing. Disruption to the availability, confidentiality and integrity of our IT systems could make it difficult to recover critical services, result in damage to assets and compromise the integrity and security of data. This could result in significant impacts to business continuity, our customer relationship and our brand reputation. Developments in data protection worldwide (such as the EU General Data Protection Regulation that comes into force in May 2018) may increase the financial and reputational implications for Prudential of a breach of its (or third-party suppliers') IT systems.

Given this, cyber security is seen as a key risk for the Group and is an area of increased scrutiny by global regulators. The threat landscape is continuously evolving, and our assessment is that the systemic risk from untargeted but sophisticated and automated attacks has increased. Cyber risks are also increasingly stemming from geopolitical tensions.

The core objectives of our Cyber Risk Management Strategy are: to develop a comprehensive situational awareness of our business in cyberspace; to pro-actively engage cyber attackers to minimise harm to our business; and to enable the business to grow confidently and safely in cyberspace.

Our Cyber Defence Plan consists of a number of work-streams, including developing our ability to deal with incidents; alignment with our digital transformation strategy; and increasing cyber oversight and assurance to the Board. We have made progress in all of these across 2017. Protecting our customers remains core to our business, and the successful delivery of the Cyber Defence Plan will reinforce our capabilities to continue doing so in cyberspace as we transition to a digital business.

The Board receives periodic updates on cyber risk management throughout the year, which includes assessments against the core objectives under our Group-wide Cyber Risk Management Strategy and progress updates on the associated Group-wide Coordinated Cyber Defence Plan.

Group functions work with each of the business units to address cyber risks locally within the national and regional context of each business, following the strategic direction laid out in the Cyber Risk Management Strategy and managed through the execution of the Cyber Defence Plan.

The Group Information Security Committee, which consists of senior executives from each of the businesses and meets on a regular basis, governs the execution of the Cyber Defence Plan and reports on delivery and cyber risks to the Group Executive Risk Committee. Both committees also receive regular operational management information on the performance of controls.

Note

1 Based on hierarchy of Standard and Poor's Moody's and Fitch, where available and if unavailable, internal ratings have been used.

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SUPERVISION AND REGULATION OF PRUDENTIAL

Prudential's principal insurance and investment operations are in Asia, the United Kingdom ('UK'), and the United States ('US'). Accordingly, it is subject to applicable Asian, UK and US insurance and other financial services regulation which is discussed below.

Group supervision

The UK's Prudential Regulation Authority ('PRA') is Prudential Group's 'lead supervisor', with a key focus on solvency and financial soundness.

The regulators which supervise the Group do so on a cross-border basis through a 'regulatory college'. The college, which meets at an annual event hosted by the PRA, includes a number of non-UK regulators who supervise Prudential's overseas operations, as well as representatives from the Financial Conduct Authority (FCA) and European Insurance and Occupational Pensions Authority ('EIOPA'). Prudential is invited to present to the College on topics pre-agreed with the PRA during the course of planning for the College.

Global regulatory developments and trends

There are a number of ongoing policy initiatives and regulatory developments at the global level that are having an impact on the way Prudential is regulated and supervised. These include the work of the Financial Stability Board ('FSB') (an international body established to coordinate, develop and promote effective regulatory, supervisory and other financial sector policies in the interest of financial stability) and the work of standard-setting institutions such as the International Association of Insurance Supervisors ('IAIS') and the International Organisation of Securities Commissions ('IOSCO').

Since 2010, the IAIS, under the auspices of the FSB and G20, has been developing a comprehensive insurance regulatory standards framework, which member regulators are expected to apply within their jurisdictions. The framework encompasses two main work streams for Group-wide insurance supervision. These sets of rules are intended to increase oversight of insurance groups and enhance existing policy measures in an attempt to reduce systemic risk. The first is a set of measures that apply to Global Systemically Important Insurers (G-SIIs) and impose additional regulatory requirements that include enhanced measures, in particular the development of Systemic Risk Management Plans ('SRMP'), Liquidity Risk Management Plans ('LRMP') and Recovery and Resolution planning; as well as the development of a capital add-on in the form of Higher Loss Absorbency (HLA). On 21 November 2017, the FSB, in consultation with the IAIS, announced a roll-over of the 2016 G-SII list as it continues to review its G-SII assessment methodology. Concurrently, the IAIS launched a public consultation in March 2017 on proposals to develop an Activities-Based Approach ('ABA') to systemic risk in the insurance sector. Once developed, this approach may have significant implications for the assessment of systemic risk and for the identification and application of G-SII measures. The second work stream, ComFrame, or the Common Framework for the Supervision of Internationally Active Insurance Groups ('IAIGs'), is a harmonised set of rules for the supervision of IAIGs. The ComFrame proposals include a risk-based global insurance capital standard ('ICS'). The ComFrame standards are still under development and are not expected to be formally adopted by the IAIS until 2020.

Prudential remains a G-SII and therefore is in scope of applicable IAIS measures.

The European Union's Solvency II Directive came into effect on 1 January 2016, although the future application of the Solvency II regime to UK insurers remains uncertain following the UK's decision in June 2016 to leave the EU ('Brexit'). A series of reviews of the Solvency II Directive are scheduled until 2021. It remains unclear what regime will be in place for UK insurers following Brexit.

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UK supervision and regulation

The Financial Services and Markets Act 2000

Prudential's insurance and investment businesses in the UK are regulated under the Financial Services and Markets Act 2000 ('FSMA 2000'), as amended by the Financial Services Act ('FS Act') 2012, the Financial Services (Banking Reform) Act 2013 and other legislation. In addition, those businesses are subject to various UK laws, such as the Data Protection Act 1998 (to be repealed in May 2018 as part of measures to implement the EU General Data Protection Regulation ('GDPR')), in relation to the processing of customer data, and various Pension Acts, some of which require the relevant Prudential entity to be licensed or registered.

UK regulatory regime

There are two principal financial services regulators in the UK:

- the PRA, which oversees macro-prudential regulation of deposit-takers, insurers and a small number of systemically important investment firms; and

- the FCA, which is responsible for conduct of business regulation of all authorised firms and the prudential regulation of firms not regulated by the PRA.

The activities of the PRA and FCA are dictated in part by initiatives developed by bodies within the European Union. In relation to Prudential's UK businesses, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority are responsible for strengthening the supervisory framework for financial services across all EU member states.

In discharging their respective functions, the PRA and FCA have separate objectives as defined in FSMA 2000 (as amended by the FS Act). The general objective of the PRA is to promote the safety and soundness of the firms it regulates. The PRA also has an insurance objective, which is to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders. The strategic objective of the FCA is to ensure that the relevant markets that it regulates function properly. The FCA is responsible for the regulation of conduct in retail as well as wholesale financial markets and the infrastructure that supports those markets. The FCA has three operational objectives: to secure an appropriate degree of protection for consumers; to protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers.

The approach of the PRA and FCA

Two of Prudential's subsidiaries that carry on insurance business in the UK (The Prudential Assurance Company Limited ('PAC') and Prudential Pensions Limited) are 'dual-regulated' firms, meaning they are regulated by the PRA for prudential purposes and by the FCA for conduct purposes. Prudential Lifetime Mortgages Limited (PLML), which undertakes lifetime mortgage business, is also dual-regulated. Although it closed to new business in April 2010, PLML continues to service its existing customers. A number of Prudential's subsidiaries are regulated by the FCA on a solo basis. This includes Prudential Distribution Limited, Prudential Financial Planning Limited, and a number of UK firms that carry on Prudential M&G's investment management business.

Close and regular contact between the PRA and FCA and senior managers remains a feature of the UK regulatory regime. Both regulators have continued to focus on risk and governance frameworks, although pursued through distinct supervisory programmes.

Both the PRA and FCA weight their supervisory activity towards those issues and insurers which, in their opinion, pose the greatest risks to their respective statutory objectives, based on a continuous cycle of assessments. For significant firms such as Prudential, the PRA conducts an annual detailed business model analysis which (in the case of an insurer) includes formulating a projection of an insurer's ability

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to generate returns, and any associated risks. The PRA may require the insurer to change its business model if it believes that mitigating measures alone cannot adequately reduce material risks to safety and soundness and to policyholder protection.

Main features of regulation applicable to Prudential's insurance and investment businesses

Principles for businesses and fundamental rules

An authorised firm is subject to a range of ongoing regulatory requirements supervised by the FCA. Dual-regulated firms are also supervised by the PRA. Two of the fundamental requirements that must be met at all times are to ensure that the firm has adequate resources to carry on its business, and to meet 'Fit and Proper' requirements. Key features of these regulatory requirements are the FCA's 11 'Principles for Businesses' and the PRA's eight 'Fundamental Rules'. These cover areas such as the firm's relationship with the FCA and PRA, the need to conduct business with integrity and the requirement to pay due regard to the interests of customers and treat them fairly.

Individual accountability

The Senior Insurance Managers' Regime ('SIMR') has applied since 7 March 2016. It is broadly in line with the Senior Manager and Certification Regime ('SMCR') implemented for the banking sector in the UK, but with some differences which arise from Solvency II systems of governance requirements. The SIMR focusses in particular on the conduct of senior managers and their individual responsibility for decisions. This emphasis on senior executive conduct and accountability allows the PRA to subject any firm that fails to uphold the new requirements to regulatory censure. Senior managers have core responsibilities prescribed to them, according to their role.

The SIMR introduced the concepts of 'Senior Insurance Management Functions', 'Significant Influence Functions' and 'Key Functions'. An operational failure of any of these functions (owing to mismanagement or a lack of proper oversight) could lead to significant losses being incurred by the business and a failure of the firm's ongoing ability to meet its obligations to policyholders. The system of governance of each Solvency II insurance firm and group needs to cover at least the following key functions: risk management, compliance, internal audit and actuarial.

The SIMR will ultimately be replaced by the SMCR, which is to be extended to cover all regulated financial institutions (including insurers) later in 2018. This will place additional responsibility on insurers and asset managers to identify a population of certificated individuals who will be required to meet the 'Fit and Proper' requirements. The new regime will also require firms to notify the regulators in the event of disciplinary action taken against senior managers for breaches of conduct rules.

Capital requirements for insurers

As noted above, in order to maintain authorised status under the FSMA 2000, firms must continue to satisfy certain threshold conditions which, *inter alia*, require firms to have adequate resources for the carrying on of their business. The majority of the rules which govern the prudential regulation of insurers are currently found in the 'Minimum Capital Requirement', 'Own Funds' and 'Solvency Capital Requirement' parts of the PRA Rulebook, which came into force on 1 January 2016 as part of the implementation of Solvency II.

Solvency II's main aim is to ensure the financial stability of the insurance industry and to protect policyholders through revised solvency requirements which are better matched to the true risks of the business. The framework is outlined in the Solvency II Directive, with much of the detail in the rules set out in the Solvency II Delegated Regulation and certain 'Level 2' implementing measures. These measures are accompanied by further requirements developed by EIOPA, namely, the Implementing

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Technical Standards (which aim to ensure the uniform application of the Solvency II Directive) and Guidelines necessary to guarantee convergence of Solvency II implementation.

A key element of Solvency II is the focus on a supervisory review at the level of the individual legal entity. Insurers have been encouraged to improve their risk management processes and are allowed to make use of internal economic capital models to calculate capital requirements, subject to approval by the local regulator (the PRA in the UK). In addition, Solvency II requires firms to develop and embed an effective risk management system as a fundamental element of running the firm.

The regime also requires firms to disclose a considerably greater level of qualitative and quantitative information, both to their own supervisor (through Regular Supervisory Reporting ('RSR')) and to the market (through the publication of a Solvency and Financial Condition Report ('SFCR')). This is intended to increase transparency, facilitate comparison across the industry and enable supervisors to identify if firms are heading for financial difficulty at an earlier stage.

Further details on the Group Solvency II capital position at 31 December 2017 are set out in the Capital Position section within Explanation of Performance and Other Financial Measures.

Conduct of business rules

The FCA's Conduct of Business Rules (and, for insurers, the FCA's Insurance Conduct of Business Rules) stipulate the day-to-day standards that should be observed by authorised persons when carrying on regulated activities.

The scope and range of obligations imposed on an authorised firm under these Rules varies according to its business and the range of its clients. Generally, the obligations imposed on an authorised firm include the need to categorise its clients according to their level of sophistication, provide them with information about the firm, meet certain standards of product disclosure, ensure that promotional materials which it produces are clear, fair and not misleading, assess suitability when advising on certain products, manage conflicts of interest, report appropriately to its clients and provide certain protections in relation to client assets. Additional details of relevance to the insurance and investment businesses are discussed below.

Authorised firms which advise and sell to retail customers packaged products such as life insurance policies are subject to detailed conduct of business obligations relating to product disclosure, assessment of suitability, the range and scope of the advice which the firm provides, and fee and remuneration arrangements.

Financial advice and fairness

In March 2016, HM Treasury and the FCA published their Financial Advice and Market Review final report, which set out 28 recommendations to increase the accessibility and affordability of the advice and guidance that consumers receive in the UK.

This review considered all types of retail financial products including pensions, savings, mortgages and insurance. The recommendations focused on three key areas:

- affordability advice and guidance to the mass market should be more cost-effective. Firms should develop more streamlined services and engage with customers in a more effective way.

- accessibility implementing procedures to help consumers engage more effectively with advice. These include making consumers' own information more easily available to them and to those who advise them, the development of "rules of thumb" and the use of 'nudges' to encourage customers to seek support at key life stages. The report also recommend measures to help employers give more support to their staff on financial matters; and

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liabilities and consumer redress recommendations to increase clarity and transparency about the way in which the Financial Ombudsman Service ('FOS') deals with consumer complaints. The report also makes recommendations in relation to the FCA's review of funding the Financial Services Compensation Scheme ('FSCS') to assist advisers struggling to predict and budget for the levy they have to pay.

Many of these recommendations have now been implemented, with outstanding changes to be implemented throughout 2018.

Thematic Review of Non-Advised Annuity Sales Practices

On 14 October 2016, the FCA published its findings following the conclusion of its 'Thematic Review of Non-Advised Annuity Sales Practices'. The FCA wanted to establish whether firms provided customers with sufficient information about enhanced annuities. In conjunction with this, Prudential has agreed with the FCA to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review will examine whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. The FCA formally released its redress calculation methodology in early 2018 and accordingly Prudential reassessed the provision held to cover the costs of undertaking the review and any potential redress. At 31 December 2017, following this reassessment, the gross provision was increased to £400 million (2016: £175 million), excluding any utilisation during the year. The ultimate amount that will be expended by the Group on the review, which is currently expected to be completed in 2019, remains uncertain. Although the Group's professional indemnity insurance is expected to mitigate the overall financial impact of this review, with potential insurance recoveries of up to £175 million, no such recovery has been factored in the provision, in accordance with the requirements of IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'.

Consumer protection, the FOS, the FSCS and the Pension Protection Fund ('PPF')

Authorised firms must have appropriate complaints handling procedures, the standards for which are set out in the FCA Handbook. However, once these procedures have been exhausted, qualifying complainants may turn to the FOS. The FOS is empowered to order firms to pay fair compensation for loss and damage and may order a firm to take such steps as the FOS determines to be just and appropriate in order to remedy a complaint. The actual level of compensation customers receive will depend on the basis of their claim. The FSCS only pays compensation for financial loss.

The FSCS is intended to compensate individuals and other groups of 'eligible claimants', including certain trustees, for claims against an authorised firm where the authorised firm is unable or unlikely to be able to meet those claims (generally, when it is insolvent or has gone out of business). Both the PRA and the FCA have rule-making powers for the FSCS and the FSCS is accountable to both regulators.

In addition, the PPF is a statutory fund aimed at protecting members of eligible pension schemes where their employer (or a past employer) has become insolvent and the pension scheme can no longer afford to pay the promised pension.

All of the above schemes are funded by levies on the UK financial services industry. The FCA has proposed changes to the apportionment of levies that fund FSCS compensation costs. Of these, the most significant proposal is the requirement for product manufactures to pay 25 per cent of the levy required to fund claims arising from the activity of intermediaries. At present, this levy is applied in its entirety to the intermediary market. A policy statement is expected in the second quarter of 2018 with any rule change expected to be effected in 2019.

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Financial crime

The prevention of financial crime is a key element of the FCA's statutory remit to protect the integrity of the UK financial system. The FCA provides regulatory oversight of financial crime, including anti-money laundering, sanctions, and anti-bribery and corruption. The FCA requires firms to put in place appropriate systems and controls to mitigate financial crime risks, and it examines these on an ongoing basis as part of its proactive supervision agenda.

The UK is a member of the Financial Action Task Force ('FATF'), an international body that sets the standard for anti-money laundering. The FATF conducts scheduled mutual evaluation reviews of member countries and these help anticipate regulatory expectations. The FATF is scheduled to carry out its next mutual evaluation of the UK during 2018.

The Fourth Anti Money Laundering Directive was adopted by the European Parliament and EU Council of Finance Ministers in May 2015 and took effect in June 2017. Following consultation by the UK Government it was transposed in to the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017. UK firms are required to comply with the new regulations. Prudential analysed the revised EU rules and has implemented all required changes.

UK firms are required to disclose suspicions of money-laundering to the National Crime Agency. The FCA can take enforcement action against firms that fail to manage their financial crime risks effectively.

General Data Protection Regulation

The European Commission proposed EU Data Protection Reform in January 2012, in order to adapt data protection rules to the digital environment and harmonise the legislative environment across the EU.

The General Data Protection Regulation ('GDPR') was adopted by the European Parliament and the EU Council of Finance Ministers in April 2016 and will apply from May 2018. The business has reviewed the requirements and identified the changes to incorporate these. An implementation plan is in place and we are working with outsourced service providers to make the necessary changes.

With-profits business

There is a requirement for every insurance company that carries on long-term business to appoint one or more actuaries to perform the actuarial function in respect of all classes of its long-term insurance business and the with-profits actuary function in respect of all classes of any with-profits business. Alongside the with-profits actuary, and also forming part of the 'second line of defence' from a compliance perspective, with-profits businesses are required to appoint a with-profits committee. This committee is composed of independent persons and acts in an advisory capacity to inform the decision-making of an insurer's governing body and to ensure that the interests of with-profits policyholders are adequately considered. The with-profits committee advises on the appointment of, and works closely with, the with-profits actuary.

The with-profits business has long been an area of focus for regulators, including: the costs charged to a with-profits fund by the firm managing the fund; penalties and charges levied on policyholders who surrender their policies early; the need for funds to be managed with the objective of ensuring that maturity payouts fall within a target range set for the fund; and the provision of information to with-profits policyholders or potential policyholders in a format that they can readily understand.

The PRA and FCA share responsibility for the supervision of with-profits business. The PRA views the regulation of with-profits business as an important element of its approach to insurance supervision. The PRA and FCA will continue to liaise on the regulation and supervision of with-profits business according to the framework set out in the with-profits Memorandum of Understanding dated 1 April 2013. The PRA seeks to ensure that any discretionary benefit allocations or other changes with financial

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implications that the insurer has proposed are compatible with its continued safety and soundness, whereas the FCA has responsibility for monitoring whether the proposed changes are consistent with the insurer's previous communications, the FCA's conduct rules and the overriding obligation to treat customers fairly. The PRA has the power to prevent allocations being made if they would materially impair the firm's safety and soundness.

Pensions

The Pensions Regulator ('TPR') is the statutory regulator for all work-based pension schemes in the UK.

Its statutory objectives are set out in the Pensions Act 2004, as amended by the Pensions Acts 2008 and 2014. These are to protect the benefits of members of occupational pension schemes; to protect the benefits of members of personal pension schemes where direct payment arrangements are in place; to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund ('PPF'); in relation to defined benefit ('DB') scheme funding only, to minimise any adverse impact on the sustainable growth of an employer; to maximise employer compliance with employer duties and the employment and pre-employment safeguards; and to promote, and to improve understanding of, the good administration of work-based pension schemes.

A memorandum of understanding between TPR and FCA sets out the arrangements for cooperation and coordination in carrying out their respective regulatory responsibilities between various Pensions Acts, FSMA 2000 and other relevant legislation.

There is a separate ombudsman, The Pensions Ombudsman, who investigates and decides complaints and disputes over the manner in which pension schemes are run, and works closely with The FOS in cases where their remit overlaps.

Regulation of investment business

Certain of Prudential's subsidiaries are authorised to carry on investment business and are subject to regulation and supervision under FSMA 2000. UK asset management can also be subject to additional regulation in other jurisdictions in which they operate. For example, certain M&G UK subsidiaries that operate outside of the UK are also subject to regulation by local regulatory authorities.

Markets in Financial Instruments Directive ('MiFID')

MiFID sets out detailed authorisation and operating conditions for investment firms and regulated markets. In October 2011, the European Commission published proposals to amend MiFID, the 'MiFID II' Directive and introduce a new Markets in Financial Instruments Regulation ('MiFIR'). Implementation of the new laws took effect from 3 January 2018, one year after the original deadline. There has been significant work done across the industry as a whole to build good practice and consistency across MiFID II for example in Product Governance.

Insurance Distribution Directive

The Insurance Distribution Directive (IDD), like MiFID II, is designed to increase consumer protection by updating its predecessor, the Insurance Mediation Directive. Both MiFID II and IDD look to enhance consumer protection via a number of common conduct topics, for example, product oversight and governance, suitability, appropriateness, conflicts of interest and inducements. The IDD was originally due to come into force on 23 February 2018. The European Commission has proposed to delay the application date of the IDD until 1 October 2018 but the delay is subject to further legislative procedure at EU level. Her Majesty's Treasury (HMT) has subsequently announced its intention not to transpose the IDD into UK national law before the delay is confirmed at EU level. This means that firms will not

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have to implement these requirements by 23 February 2018. It is anticipated that the revised application date, still expected to be 1 October 2018, will be officially confirmed around mid-March 2018.

Packaged Retail Insurance-Based and Investment Products Regulation ('PRIIPs')

In order to facilitate similar disclosure for all investment products sold to retail clients (including insurance contracts), PRIIPS Regulation requires the production of the Key Information Document ('KID') for products and allows a separate document to show information on the funds. The KID will be a short and consumer-friendly document that will give investors all the key facts and figures about a PRIIP. The PRIIPs Regulation was agreed by the European Parliament and EU Council of Ministers in March 2014 and became effective on 1 January 2018. The relevant entities of M&G Prudential to which PRIIPs apply have Implemented the requirements.

Advising on Pension Transfers

On 21 June 2017, the FCA published proposed changes to its rules and guidance on advising on pension transfers. The aim of the proposals is to improve consumer outcomes through improving the quality of advice on pension transfers. Final rules are expected in March 2018.

Retirement Outcomes Review

In July 2017 the FCA published its interim report from its Retirement Outcomes Review. It sets out it findings within the sector and has invited feedback from the industry on several potential remedies. They include default investment pathways and a charge cap for non-advised drawdown, removing the requirement to take benefits from a plan to access the tax free cash element and mandating the use of a summary cost indicator in customer communications. The final report is expected in the second quarter of 2018.

European Market Infrastructure Regulation ('EMIR')

The Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties ('CCPs') and trade repositories, widely known as European Market Infrastructure Regulation, ('EMIR'), came into force on 16 August 2012, with its key provisions taking effect on a phased basis. Full implementation is expected to be achieved by the end of 2020. EMIR's rules are intended to lessen risk and increase transparency within the OTC derivative markets by introducing for most counterparties: (i) a reporting obligation for all derivatives; (ii) a clearing obligation for eligible OTC derivatives; (iii) measures to reduce counterparty credit risk and operational risk for bilaterally traded OTC derivatives, including through collateral requirements; (iv) common rules for CCPs and for trade repositories; and (v) rules on the establishment of interoperability between CCPs. Funds may have to hold more eligible collateral (cash and government bonds) in order to post initial margin.

The relevant EU-domiciled Prudential Group entities have implemented the necessary changes to comply with EMIR requirements currently in effect, including the start of reporting practices and measures to reduce risk for bilaterally traded OTC derivatives. The clearing obligation for certain interest-rate derivatives applied to Prudential Group entities and a few M&G funds from 21 December 2016 and mandatory two-way variation margin has been posted on non-cleared OTC derivatives since 1 March 2017.

Regimes for the exchange of tax information

Financial institutions in the UK are increasingly being required to provide certain information about their customers, or persons who control their customers, to HMRC. This is due to the introduction and domestic implementation of various international reporting and transparency regimes, including FATCA, the OECD's Common Reporting Standard (the 'CRS') and the EU Directive on administrative cooperation

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in the field of taxation (the 'DAC'). The information obtained by HMRC may be exchanged with tax authorities in other countries. The obligations of UK financial institutions to report information to HMRC for the purposes of FATCA, the CRS and the DAC are set out in the International Tax Compliance Regulations 2015 (SI 2015/878) (the "International Tax Compliance Regulations").

For further information about the impact of FATCA, please see 'US Supervision and Regulation Implementation of US Foreign Account Tax Compliance Act ('FATCA') provisions' below.

The UK Criminal Finances Act 2017 created two new corporate criminal offences for corporates which fail to prevent the facilitation of tax evasion. Prudential has taken measures to ensure it is in compliance with the Act.

Asian supervision and regulation

1. Regulators, Laws and Major Regulations of Insurance Business

Prudential's businesses in Asia are subject to all relevant local regulatory and supervisory schemes. These laws and regulations vary from country to country, but it is the local regulators that typically grant (or revoke) licenses and therefore control the ability to operate a business.

The regulatory environment continues to evolve in Asia, where economies in the region are in various phases of maturity. In general (though there are exceptions), regulators in developing economies continue to build the regulatory framework relevant to their level of economic development. This increased regulatory pressure will continue to affect Prudential's Asian businesses.

In general, regulatory regimes will include features governing the registration of agents, regulation of product features, approval of products, asset allocation, minimum capital, the basis for calculating the company's solvency and reserves, the valuation of policyholder liabilities, conditions for outsourcing functions, corporate governance risk management, policyholder and investor protection, as well as anti-money laundering ('AML') and sanctions, 'know your client' requirements and data protection requirements. Regulatory authorities may also regulate affiliations with other financial institutions, shareholder structures and the injection of capital and payment of dividends. Financial statements and other returns are filed with the regulators. A number of jurisdictions across Asia require insurance companies to participate in policyholder protection schemes (ie contribute to a fund to support policyholders in the event of an insurance company failing).

The increasingly extraterritorial approach of certain regulators outside Asia, aimed among other things at protecting financial systems from systemic risks and curbing tax avoidance, could have wider consequences on financial groups in the Asia-Pacific region. For example, financial institutions are required to comply with new tax information exchange/disclosure regulations or standards with extraterritorial reach such as the US Foreign Account Tax Compliance Act ('FATCA') provisions' below and the Organisation for Economic Co-operation and Development's Common Reporting Standard ('CRS') which aims to increase global tax transparency and improve international tax compliance. Significant changes to business processes and systems are required by Prudential's businesses in Asia in order to comply with the new requirements to identify and report on non-local tax residents. The effects of anti-bribery legislation in the UK, US and elsewhere have also become increasingly significant outside of such legislations' home jurisdictions. Prudential Corporation Asia's ('PCA's') business units are required to adhere to Prudential's group-wide policy designed to comply with the EU Solvency II requirements. In addition, where applicable, the local businesses shall also follow the local risk based capital (RBC) requirements, some of these RBC frameworks follow similar principles of those of the Solvency II.

Conduct of Business and Consumer Protection continue to be a key priority for regulators in Asia. The focus continues to be on product design, commission structure, marketing literature and sales processes, and agency business models.

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Significant additional details of the regulatory regimes to which PCA's insurance operations are subject are discussed below:

Indonesia PT. Prudential Life Assurance

PT. Prudential Life Assurance is authorised to carry on long-term (ie for an indefinite period) insurance business in Indonesia. Prudential's operations in Indonesia are authorised to distribute life insurance products based on either conventional or Shariah principles, through agency and bancassurance (including direct marketing) channels.

The Otoritas Jasa Keuangan ('OJK') is the regulator responsible for supervising the banking industry, capital markets and insurance industry. The financial regulatory regime in Indonesia operates on a 'twin peaks' model with the OJK responsible for microprudential supervision and Bank Indonesia ('BI') retaining its macroprudential responsibilities. The implementation of AML controls in the insurance industry is monitored by the Indonesian Financial Transaction Reports and Analysis Center (or Pusat Pelaporan dan Analisis Transaksi Keuangan in Indonesian (the 'PPATK').

Law No. 40 of 2014 on Insurance which was enacted on October 17, 2014 is the principal legislation relating to insurance business (Insurance Law). Pursuant to Law Number 40, year 2014, the Government plans to issue new regulations regarding foreign ownership in insurance companies. Pending the enactment of any new regulation, the maximum foreign ownership in insurance companies is subject to the provisions under the old insurance law.

Singapore Prudential Assurance Company Singapore (Pte.) Limited

Prudential Assurance Company Singapore (Pte.) Limited is registered by the Monetary Authority of Singapore (the 'MAS') to design and sell both life and accident and health insurance products pursuant to the Insurance Act and Financial Advisers Act.

Under the Insurance Act, the MAS is responsible for insurance regulation and supervision of insurance companies. MAS regulation covers, *inter alia*, product development, pricing and management of insurance products, market conduct standards, investments undertaken, public disclosure requirements, reinsurance management, maximum representatives tier structure, loans and advances and product disclosure. The MAS also issues directions and regulations for the prevention of money laundering and to counter financing terrorism; this is in addition to the general AML law under which suspicious transactions must also be notified to the Commercial Affairs Department, an enforcement agency of the Singapore Police Force.

In addition, the Singapore Financial Adviser Act gives the MAS the authority to regulate and supervise all financial advisory activities conducted by insurance companies. MAS regulation covers, among other things, the appointment and training of representatives, disciplinary action, mandatory disclosure to clients, sales and recommendations process on investment products, replacement (switching) of investment products and fair dealings with customers. Mandatory disclosure to clients covers both product information and basic data about the representatives and the firm.

The MAS has implemented regulations to give effect to the policy proposals under the Financial Advisory Industry Review ('FAIR') with the aim of raising the standards and professionalism of the financial advisory industry and enhancing the market efficiency of the distribution of life insurance and investment products in Singapore. FAIR introduced the balanced scorecard remuneration framework that rewards the provision of quality advice in order to align the interests of representatives with that of customers. A direct channel was also required of each insurance company, through which basic insurance products can be purchased without incurring commissions. A web aggregator to enhance comparability amongst life insurance products has also been launched.

In addition, the Central Provident Fund (the 'CPF') Board acts as a trustee of social security savings schemes jointly supported by employees, employers and the government. The CPF Board regulates insurers in the operation of various CPF schemes including the CPF Investment Scheme where CPF monies are used by policyholders to purchase insurance policies such as annuities and investment linked policies.

The MAS has detailed regulatory frameworks to govern insurance companies and the distribution of insurance products in Singapore.

Hong Kong

Prudential currently operates two subsidiaries, Prudential Hong Kong Limited ('PHKL') and Prudential General Insurance Hong Kong Limited ('PGHK'), to manage separately the life and general businesses. Both entities' market conduct is regulated by the relevant regulators in Hong Kong.

The newly established Hong Kong Insurance Authority (HKIA) officially commenced operations on 26 June 2017, taking over from the Office of the Commissioner of Insurance which was disbanded on the same day. The HKIA is responsible for administering the Insurance Ordinance. Its objectives are to: modernise the insurance industry regulatory infrastructure to facilitate the stable development of the industry, provide better protection for policyholders and comply with the requirements of the 'IAIS' insurance regulators should be financially and operationally independent from the government and industry. The intention is for HKIA to be more independent of the government than the Office of the Commissioner of Insurance (OCI). It has a long-term aim to be funded independently of government and a new policyholder levy of 0.1% of insurance premium will begin on 1 January 2018, subject to a cap of HKD 100 on long term insurance policies and HKD 5,000 on general insurance policies.

HKIA will be around twice the size of OCI and it will have additional investigatory powers such as the right to enter an insurer's premises and take copies of records and documents without warrant. A separate team has been created for investigations which is expected to make greater use of data analysis than OCI. HKIA will also take over licencing from Insurance Agents Registration Board (IARB) in 2018.

The sale of mandatory pension products by agents is regulated by the Mandatory Provident Fund Authority which licenses and supervises the conduct of MPF intermediaries, and the Securities Futures Commission.

In February 2016, the State Administration of Foreign Exchange in China enforced a limit (that was put in place in 2011) on the use of UnionPay bank cards, Visa and Master Card issued by China domestic banks to purchase insurance products overseas; each transaction is capped at USD 5,000. Since November 2016 UnionPay bank cards are not allowed to be used to pay premiums for insurance products with investment-related contents.

Malaysia Prudential Assurance Malaysia Berhad

Prudential Assurance Malaysia Berhad ('PAMB') carries out life insurance business in Malaysia.

The Bank Negara Malaysia ('BNM') is the central bank of Malaysia and is the regulatory body responsible for supervising and regulating the financial services sector, including the conduct of insurance and Takaful (insurance that is compliant with Islamic principles) business. BNM places considerable emphasis on fair market conduct by the insurance industry and protection of consumers' interests and is also responsible for administering legislation in relation to AML matters. BNM has the power to enforce sanctions on financial institutions.

In addition, PAMB is a member of the Life Insurance Association of Malaysia ('LIAM'), a self-regulatory body. Resolutions and circulars issued by LIAM are binding on the member insurance companies.

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The Financial Services Action 2013 ('FSA') is the principal legislation governing insurance businesses in Malaysia. The FSA provides for the regulation and supervision of financial institutions, payment systems and other relevant entities and the oversight of the money market and foreign exchange market to promote financial stability and for related, consequential or incidental matters. Under the FSA, insurers holding composite licenses are prohibited from carrying out both general and life insurance businesses. Consequently, PAMB sold off its general insurance portfolio to another insurer in 2017. Further, the FSA covers, among other things provisions for licensing of insurers, prudential requirements, corporate governance, management of insurance funds, financial holding companies, business conduct and consumer protection, and powers granted to BNM for enforcement and supervision, The FSA also places greater accountability on the board of directors and senior management in their management and oversight of an insurer.

BNM issued the Life Insurance and Family Takaful Framework ('LIFE Framework') in November 2015.The LIFE Framework aims to promote innovation and a more competitive market supported by higher levels of professionalism and transparency in the provision of insurance and Takaful products and services. This will be achieved through specific initiatives introduced under the 3 Pillars of the LIFE Framework.

Under Pillar 1, limits on operational costs will gradually be removed to promote product innovation while preserving policy value.

Under Pillar 2, distribution channels will be widened. Life insurance/family Takaful products will be accessible to consumers through a wide range of delivery channels that are most convenient and appropriate.

Under Pillar 3, market conduct in general will be strengthened to enhance consumer protection. The level of professionalism of intermediaries is proposed to be enhanced so as to ensure consumers are given proper advice.

The LIFE Framework is being implemented by BNM in phases between 1 December 2015 to 1 January 2019, to take into account the current state of readiness of the life insurers, family Takaful operators and intermediaries, and the level of consumer awareness and literacy.

Market liberalisation measures were introduced by BNM in April 2009, which increases the limit from 49 per cent to 70 per cent on foreign equity ownership for insurance companies and Takaful operators in Malaysia. A higher foreign equity limit beyond 70 per cent for insurance companies will be considered by BNM on a case-by-case basis for companies who can facilitate consolidation and rationalisation of the Malaysian insurance market.

Malaysia (Takaful business) Prudential BSN Takaful Berhad

Prudential BSN Takaful Berhad ('Prudential Takaful') (a Prudential joint venture with Bank Simpanan Nasional) was one of the first overseas insurers to be granted a domestic Takaful License in Malaysia.

The Takaful business in Malaysia is also regulated by BNM. In addition, Prudential Takaful is also a member of the Malaysian Takaful Association ('MTA'), an association for Takaful operators that seeks to improve industry self-regulation through uniformity in market practice and to promote a higher level of co-operation.

Takaful in Malaysia is considered to be part of mainstream mercantile law, and is subject to the civil court structure at the federal level. It is not regulated by Shariah law in Shariah courts as the Shariah courts do not deal with commercial transactions. However, the operations of a Takaful Operator ('TO') must conform to the rules and requirements of Shariah as regulated in the Islamic Financial Services Act 2013 ('IFSA'), which came into effect from 30 June 2013, repealing the earlier Takaful Act 1984. The IFSA provides a comprehensive legal framework that is fully consistent with Shariah in all aspects of regulation and supervision, from licensing to the winding-up of an institution. The IFSA is similar to the FSA issued for conventional insurers.

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The IFSA recognises the BNM's Shariah Advisory Council ('SAC') as the sole authority on Shariah matters. As the reference body and advisor to BNM on Shariah matters, the SAC is also responsible for validating all Takaful products to ensure their compatibility with Shariah principles. A TO is also required to establish a Shariah Committee, approved by BNM, to which the SAC will give guidance and advice on operations and business activities. BNM has also issued a specific Shariah Governance Framework that prescribes governance arrangements for Islamic Financial Institutions, including TOs.

The BNM's LIFE Framework referred to in the subsection above also impacts on the family Takaful industry.

Vietnam Prudential Vietnam Assurance Private Limited

Prudential Vietnam Assurance Private Limited ('PVA') is licensed and regulated by the Ministry of Finance of Vietnam (the 'MoF') as a life insurance company. An insurance company is not permitted to operate both life and non-life insurance at the same time, except in the case of a life insurance company that offers personal health and protection care insurance as a supplement to life insurance.

The Insurance Supervision Authority of the MoF specifically undertakes the supervision of insurance companies. The fundamental principles of the operation of insurance companies are set out in the Insurance Business Law.

AML controls in the insurance industry are monitored by the Anti-Money Laundering Department under the Banking Inspectorate and Supervision Department of the State Bank of Vietnam.

Thailand Prudential Life Assurance (Thailand) Public Company Limited

Prudential Life Assurance (Thailand) Public Company Limited ('PLT') holds a life insurance license and is authorised to offer life insurance products. This also includes an authorisation to offer products with an investment linked feature.

PLT is regulated and supervised by the Office of Insurance Commission ('OIC'), the independent regulatory organisation handling day-to-day insurance business affairs and reporting to the Ministry of Finance. The OIC has the power to manage and supervise insurance companies, protect insured persons and the general public, implement policies with respect to insurance funds, and regulate the professional conduct, qualifications and licensing of insurance brokers, agents and actuaries.

In respect of AML, all life insurance businesses are also regulated by the Anti-Money Laundering Office ('AMLO'), the authority responsible for enforcement of the Anti-Money Laundering Act, B.E. 2542 (1999). AMLO is an independent governmental agency and all suspicious transaction reporting is to be made to the AMLO.

In October 2017, OIC issued draft amendments to Life Insurance Act, which proposed new/amended provisions for the regulation of electronic transactions and to increase supervision of agents and brokers.

India ICICI Prudential Life Insurance Company Limited

ICICI Prudential Life Insurance Company Limited (an associate in which Prudential has a 26 per cent share and the major shareholder is ICICI Bank Limited) is authorised to carry out long-term life insurance business in India.

The Insurance Regulatory & Development Authority of India ('IRDA') is the regulator for insurance business in India. The IRDA's duties include issuing certificates of registration to insurance companies, protecting the interests of policyholders, and regulating, promoting and ensuring the orderly growth of the insurance industry.

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The principal legislation for insurance business is the Insurance Act 1938. Regulations and guidelines on specific matters have also been published to fulfil the purposes of the Insurance Act and to provide rules and norms for conduct of operations. In relation to AML and counter financing of terrorism ('CFT') requirements, insurers must also adhere to requirements of the Prevention of Money Laundering Act 2002 and specific guidelines issued by the IRDA in this regard. The Financial Intelligence Unit-India ('FIU-IND') is entrusted with the responsibility of receiving cash/suspicious transaction reports, analysing them and, as appropriate, disseminating valuable financial information to intelligence/enforcement agencies and regulatory authorities.

China CITIC-Prudential Life Insurance Company Limited

CITIC-Prudential Life Insurance Company Limited (Prudential's joint venture with CITIC in which Prudential has a 50 per cent share) is authorised to conduct life insurance business in China. To date, CITIC-Prudential Life has business across China including the key markets of Guangdong, Beijing, Shanghai, Shenzhen, Hubei, Shandong, Zhejiang, Jiangsu, Tianjin, Guangxi, Fujian, Hebei, Liaoning, Shanxi, Henan and Sichuan.

The body responsible for regulation of the insurance sector is the China Insurance Regulatory Commission ('CIRC'). CIRC reports directly to the State Council. CIRC is authorised to conduct the administration, supervision and regulation of the Chinese insurance market, and to ensure that the insurance industry operates in a stable manner in compliance with the law. CIRC also has local offices in all 41 provinces and selected direct administrative cities and regions across the country, which set and administer implementation rules and guidelines in the application of the regulations introduced by CIRC.

CIRC has focused specific attention on the area of risk prevention, with five identified lines of defence against risks, namely; internal management and control systems, supervision of solvency adequacy, on-site inspection, fund management regulation and insurance security fund. In response to the global financial crisis, more importance has been attached to the supervision of internal control systems, corporate governance, and market conduct and information disclosure by insurance companies.

The People's Bank of China ('PBOC') is entrusted with responsibility and authority to regulate all anti-money laundering activities in China and has actively been developing rules and guidance, requiring insurance companies to abide by the PRC's main AML law and regulations in connection with capital investment, transfers and set-up of new branches, as well as specifying senior management's responsibilities on AML.

Philippines Pru Life Insurance Corporation of UK

Pru Life Insurance Corporation of UK is licensed in the Philippines as a life insurance company and is also permitted to offer health, accident and disability insurance.

The Insurance Code of the Philippines, as amended ('Insurance Code'), gives the power to supervise and regulate the operations and business of insurance companies to the Insurance Commission ('IC'). The IC is a government agency under the Department of Finance, and is headed by the Insurance Commissioner. IC regulation and supervision seeks, amongst other things, to ensure that adequate insurance protection is available to the public at a fair and reasonable cost and to ensure the financial stability of the insurance industry so that all legitimate claims of the insured public are met promptly and equitably, and to safeguard the rights and interests of the insured.

The implementation of AML controls for both in the insurance and the banking industries is monitored by the Anti-Money Laundering Council ('AMLC') where all covered transactions under the Anti-Money Laundering Act of 2001 ('AMLA') are to be reported to AMLC.

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Taiwan PCA Life Assurance Company Limited

PCA Life Assurance Company Limited is licensed to conduct life insurance business in Taiwan.

The Financial Supervisory Commission ('FSC') is responsible for regulating the entire financial services industry, including the banking, securities and insurance sectors. The FSC's responsibilities include supervision, examination and investigation. The Insurance Bureau ('IB') under the FSC acts as the executive supervisory authority for the FSC and is responsible for the insurance sector, while the Financial Examination Bureau (the 'FEB') principally carries out examinations and on-site visits of all financial institutions, including insurance companies, generally every two years.

The Anti-Money Laundering Division ('AMLD') as part of the Investigation Bureau under the Ministry of Justice is responsible for supervision of AML and counter financing of terrorism ('CFT') efforts.

Cambodia Prudential (Cambodia) Life Assurance Plc

Prudential (Cambodia) Life Assurance Plc received its full operating licence from the Ministry of Economy and Finance (MEF) on 31 December 2012 and started selling life insurance policies in January 2013.

The Insurance and Pension Department of the General Department of Financial Industry, a division of the MEF, is the insurance regulator.

Insurance activities are principally governed under the Insurance Law, which came into effect in 2000 (and was further amended in 2014) and the Sub-Decree on Insurance, which was adopted by the Government in September 2001. The MEF has also published specific guidelines on aspects of insurance operations and corporate governance.

Laos Prudential Life Assurance (Lao) Company Limited

Prudential Life Assurance (Lao) Company Limited received its insurance business operating licence from the Ministry of Finance ('MOF') on 5 April 2016 and commenced life insurance operations in the country in May 2016.

Insurance supervision comes under the purview of the MOF. The insurance regulatory framework is based on the Law on Insurance dated 21 December 2011 and the Ministerial Instruction on Implementing the Law on Insurance dated 19 February 2014.

2. ***Regulation of investment and funds businesses and other regulated operations***

Prudential conducts investment and fund businesses through subsidiaries or joint ventures ('JV') in Asia through Eastspring Investments: Hong Kong, Japan, Korea, Taiwan, The People's Republic of China, India, Singapore, Malaysia, Vietnam and Indonesia. Eastspring Investments also has a presence in Luxembourg, the US and the UK. All operations are authorised and licensed by the relevant authorities. Depending on the licensing regime in the respective countries, Eastspring entities are generally authorised to conduct fund/investment management and investment advisory activities for both retail and institutional funds. In addition, two of the JV companies are licensed to provide Trust services to funds.

The relevant authorities generally have broad supervisory and disciplinary powers, including the power to set minimum capital requirements, to temporarily or permanently revoke the authorisation to carry on regulated business, to suspend registered employees/licensed representatives, and to invoke censures and fines for both the regulated business and its registered employees/licensed representatives. Although the detailed regulations vary, common features of the regulatory regimes in each jurisdiction tend to include investment restrictions, advertising codes, requirements on treating customers fairly, disclosure requirements in prospectuses and/or marketing materials, requirements to seek unit holders'

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approvals in certain instances, provision of financial statements and other periodic disclosures to regulators and audits by regulators.

In general, regulators across Asia have introduced various regulations aimed at improving the overall standards of the financial industry to be in line with international standards. The common focus among the different regulators remains on Anti-Money Laundering / Know Your Customers, customer protection, increasing management accountability and fund risk management. In Europe, regulators' focus is on the protection of client interest and data as well as improving market transparency.

Looking ahead to 2018, Asian regulators in Singapore, Hong Kong, Japan, Korea and Indonesia have all set up initiatives to encourage the development of financial technology as well as the use of new technology to facilitate the delivery of regulatory requirements or solutions. While Fintech/ Regtech is generally viewed as a tool to improve efficiency in business processes / compliance monitoring processes, regulators have also embraced the use of technology to collect more data and potentially can increase the level of scrutiny on the industry. For example, MAS has set up the Data Analytics Group to enable more efficient supervision of regulatory compliance.

Key regulators and licences for the Eastspring businesses in Asia are as follow:

Indonesia

PT Eastspring Investments Indonesia ('Eastspring Indonesia') is licensed as an Asset Management Company. It is regulated and supervised by the OJK and operates under the Law of Indonesian Capital Market and the corresponding regulations issued by OJK.

Singapore

Eastspring Investments (Singapore) Limited ('Eastspring Singapore') is regulated by the MAS. The Company holds a Capital Markets Services Licence under the Securities and Futures Act to conduct the following regulated activities: (a) fund management; and (b) dealing in securities. Eastspring Singapore is also an exempt financial adviser under the Financial Advisers Act, Cap 110 ('FAA').

Eastspring Singapore also holds other registrations outside of Singapore, including the Registered Investment Adviser with the Securities and Exchange Commission in the United States and the Renminbi Qualified Foreign Institutional Investors ('RQFII') with the China Securities Regulatory Commission in China.

Eastspring Singapore is the appointed fund manager and global distributor of the Luxembourg SICAV funds. As such UCITS and MiFID II are both relevant.

Hong Kong

Eastspring Investments (Hong Kong) Limited ('Eastspring HK') is licensed with the Hong Kong Securities and Futures Commission ('HKSFC') and authorised to deal in and advise on securities and undertake asset management activities in Hong Kong. It also holds a QFII license issued by the China Securities Regulatory Commission ('CSRC') and the State Administration of Foreign Exchange ('SAFE'). The company is also registered with the Korea Financial Supervisory Service (KFFS) as an offshore investment advisor for investment advisory business and investment discretionary management business.

Malaysia

Eastspring Investments Berhad holds a Capital Markets Services License to conduct regulated activities in fund management and dealings in securities restricted to unit trust.

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Eastspring Al-Wara' Investments Berhad carries on Islamic asset management business to manage Shariah compliant mandates and holds a Capital Markets Services License to conduct regulated activities in fund management.

Both companies are regulated by the Securities Commission Malaysia.

Vietnam

Eastspring Investments Fund Management Company ('Eastspring Vietnam') is regulated by the State Securities Commission of Vietnam. Eastspring Vietnam is licensed to engage in investment management business and investment advisory business under the Securities Law.

India

ICICI Prudential Asset Management Company Limited is licensed to act as the Portfolio Manager under the Securities and Exchange Board of India ('SEBI') (Portfolio Managers) Regulations, 1993. It is acting as an Investment Manager of the schemes of ICICI Prudential Mutual Fund, ICIC Prudential Venture Capital Fund and Alternative Investment Funds which are registered with the SEBI.

South Korea

Eastspring Asset Management Korea Co. Ltd. ('Eastspring Korea') is regulated by the Financial Supervisory Committee ('FSC') and the Financial Supervisory Services ("FSS").

As a licensed Collective Asset Management Company (including professional private collective investment) and Discretionary and Advisory Asset Management Company, Eastspring Korea operates open/close ended funds management business and Institutional clients (such as Pooled funds, and various insurance companies) mandates management business.

China

CITIC-Prudential Fund Management Company Limited is regulated by the China Securities Regulatory Commission and holds a licence for mutual funds, Discretionary Asset Management products, Qualified Domestic Institutional Investors products and advisory services.

The legislative framework of China's fund industry comprises the China Securities Investment Funds Law and a set of ancillary regulations.

On 5 March 2018, a new investment management wholly-foreign owned enterprise (IM WFOE) has been established in China. The IM WFOE will allow Eastspring to operate an onshore investment management business in China, subject to registration of the IM WFOE with the Asset Management Association of China (AMAC) as a Private Fund Manager. Once the registration is complete, Eastspring will be able to manage and distribute private funds to qualified clients in China.

Japan

Eastspring Investments Limited ('Eastspring Japan') is registered with the Kanto Local Finance Bureau which is under the Financial Services Agency ('JFSA') to engage in (a) type II financial instruments business, (b) investment management business, (c) investment advisory & agency business under the Financial Instruments and Exchange Act ('FIEA'). Eastspring Japan is regulated and supervised by the JFSA for its day-to-day operations, including filing/ reporting.

Luxembourg

Eastspring Investments (Luxembourg) S.A. ('Eastspring Lux'), was incorporated on 20 December 2012 under the laws of the Grand Duchy of Luxembourg and is regulated by Chapter 15 of the law of

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17 December 2010 on undertakings for collective investment. Since September 30, 2013 Eastspring Lux is operating a branch in the UK, as authorised by both the Commission du Secteur Financier (the 'CSSF') and the Financial Conduct Authority (the 'FCA').

United States

Eastspring Investments Incorporated ('Eastspring US') is registered with the US SEC as a registered investment adviser under the Investment Advisers Act of 1940 in January 2014.

Taiwan

Eastspring Securities Investment Trust Co. Ltd. ('Eastspring Taiwan') is incorporated in Taiwan under the supervision of the Financial Supervisory Commission ("FSC"). The company holds licenses for launching and selling securities investment trust funds, and discretionary asset management.

US supervision and regulation

Overview

Prudential conducts its US insurance activities through Jackson, a life insurance company licensed to transact its insurance business in, and which is subject to regulation by and supervision of, the District of Columbia, and 49 of the 50 states. Jackson operates a subsidiary, Jackson National Life Insurance Company of New York, in the state of New York. The extent of 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 business conduct. In addition, statutes and regulations usually require the licensing of insurers and their agents and the approval of policy forms and related materials. The statutes and regulations of a US insurance company's state of domicile (Michigan, in the case of Jackson) also regulate the investment activities of insurers.

Insurance regulatory authorities in all the jurisdictions in which Jackson does business require it to file detailed quarterly and annual financial statements, and these authorities have the right to examine Jackson's operations and accounts. In addition, Jackson is generally subject to US federal and state laws and regulations that affect the conduct of its business, as well as similar laws and regulations in Canada and the Cayman Islands. 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. In 2016, both Michigan and New York completed examinations for the three years ended 31 December 2014 with no material findings or issues.

Jackson has historic small books of business in places such as the Cayman Islands, Puerto Rico, Guam and Argentina and the business is being managed in run-off. In addition, Jackson acquired some policies in Canada as a result of its acquisition of Reassure America Life Insurance Company (REALIC) in 2012.

Jackson's ability to pay shareholder dividends is limited under Michigan insurance law. The Director of the Michigan Department of Insurance & Financial Services (the 'Michigan Director of Insurance') may limit, or not permit, the payment of shareholder dividends if it determines that an insurer's surplus, with regard to 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. Unless otherwise approved by the Michigan Director of Insurance, dividends may only be paid from earned surplus.

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.

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Guaranty associations and similar arrangements

Each of the 50 states of the United States, the District of Columbia and the Commonwealth of Puerto Rico have laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. Guarantee funds in the US provide for payments to be made to policyholders on behalf of insolvent life insurance companies and are financed by payments assessed on solvent insurance companies based on location, volume and types of business.

The National Association of Insurance Commissioners ratios

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners ('NAIC'), in connection with the Insurance Regulatory Information System, annually calculates 12 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. The usual range of results is established by the NAIC for each ratio from studies of the ratios for companies that have become insolvent or have experienced financial difficulties in recent years. As at 31 December 2017, Jackson had no material ratios that fell outside the usual range.

Policy and contract reserve sufficiency analysis

State insurance laws require life insurance companies to conduct an annual analysis of the sufficiency of its life and annuity reserves. A qualified actuary must submit 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 surplus. The 2017 opinion has been submitted to the Michigan Department of Insurance & Finance Services without any qualifications.

Jackson's capital and surplus

Michigan insurance law requires Jackson, as a domestic 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 is subject to the supervision of the regulators of each jurisdiction. In connection with the continual licensing of Jackson, regulators have discretionary authority to limit or prohibit the 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 the further transaction of business will be hazardous to policyholders.

As a Michigan domiciled insurer, Jackson is subject to a prescribed accounting practice which under certain circumstances, allows an insurer to include the 'value of business acquired' as an admitted asset in excess of the amount allowed under NAIC guidance. At 31 December 2017, as a result of the acquisition of REALIC, Jackson admitted US$229.3 million of value of business acquired in excess of the amount allowed under NAIC guidance.

Jackson has received approval from the Michigan Department of Insurance & Financial Services regarding the use of a permitted accounting practice. This permitted practice allows Jackson to carry certain interest rate swaps at book value as if statutory hedge accounting were in place, instead of at fair value as would have been otherwise required. The permitted practice expires 1 October 2018, unless

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extended by the Michigan Director of Insurance. The effects of this permitted practice may not be considered by the company when determining the surplus available for dividends, nor the nature of dividends as ordinary or extraordinary. As at 31 December 2017 and 2016, the effect of the permitted practice decreased statutory surplus by US$480.2 million and US$413.0 million, net of tax, respectively. The permitted practice had no impact on statutory net income.

The NAIC is currently conducting a "Variable Annuity Statutory Reserve and Capital Reform" initiative with the aim of reducing the noneconomic volatility in the variable annuity statutory balance sheet and risk management. Following a quantitative impact study, changes have been proposed to the current framework and were exposed for public comment until early March 2018.

Risk-based capital

The NAIC has developed 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 risk-based capital formula standard that they calculate by applying factors to various asset, premium and reserve items and separate model based calculations of risk associated primarily with variable annuity products. The risk-based capital formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk, market risk and business risk. The NAIC designed the formula as an early warning tool to identify potentially inadequately capitalised companies for the purposes of initiating regulatory action.

Any state adopting the model act gives the state insurance commissioner 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 Department of Insurance & Financial Services takes into account the NAICs' risk-based capital standards to determine compliance with Michigan insurance law.

At 31 December 2017 Jackson's total adjusted risk-based capital substantially exceeded all applicable regulatory thresholds under Michigan's version of the model act.

The NAIC is currently reviewing a number of components of the risk-based capital framework to reflect more current modelling of asset risk (C-1 factors), tax reform (various components), operational risk and other items. Efforts are underway on these items, but an implementation date has not yet been set.

Regulation of investments

Jackson 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, common stock, real estate and foreign securities, and forbid certain other types of investments altogether. Jackson's failure to comply with these laws and regulations would cause investments exceeding regulatory limitations to be treated by the Michigan Director of Insurance non-qualified assets for purposes of measuring surplus and, in some instances, the Michigan Director of Insurance could require divestiture of non-qualifying investments.

Implementation of US Foreign Account Tax Compliance Act ('FATCA') provisions

US federal tax legislation and rules, including those relating to the insurance industry or insurance products, can have a significant impact on Prudential's business. Tax legislation and rules, and their interpretation may change, possibly with retrospective effect, and proposals that would affect such changes are debated periodically by the US Congress.

FATCA requires Foreign Financial Institutions ('FFI's) (such as Prudential plc and many of its subsidiaries) to identify US customers and report certain information on accounts held by US persons and US-owned foreign entities, to either their domestic tax authority (where there is an appropriate intergovernmental

agreement in place) for onwards transmission to the Internal Revenue Service, or directly to the IRS on an annual basis. Failure to report can lead to a 30 per cent withholding tax on certain US payments made to the FFI. The start date for implementation of the FATCA regime was 1 July 2014 with the first reports required in 2015. The 30 per cent withholding requirement applies generally with respect to US source interest, dividends and other fixed and determinable payments to persons who do not satisfy the FATCA requirements, but will not apply to payments made before 1 January 2019 to such persons with respect to gross proceeds from the disposition of property of a type that can produce US source income subject to such withholding (and, furthermore, rules for implementing the 30 per cent withholding, including on how withholding would be applied pursuant to an intergovernmental agreement, with respect to gross proceeds, have not yet been written).

The majority of countries where Prudential plc has affected subsidiaries have now entered into intergovernmental agreements with the US to simplify compliance for FFIs in those countries and minimise the risk of withholding, while still meeting the reporting obligations to the US. Prudential plc and its affected subsidiaries have established policies and procedures to ensure compliance with FATCA, including filing applicable reports.

Securities laws

Jackson, certain of its affiliates and certain policies and contracts that Jackson issues are subject to regulation under the federal securities laws administered by the SEC. 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 and (in the case of broker dealers) to impose capital and related requirements. Jackson 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 ('JNAM') is registered with the SEC as an investment adviser pursuant to the Investment Advisers Act. The investment companies (mutual funds) for which JNAM serves as an investment adviser are subject to SEC registration and regulation pursuant to the Securities Act of 1933, as amended (the 'Securities Act'), and the Investment Company Act of 1940, as amended (the 'Investment Company Act'). Certain of the mutual funds advised by JNAM underlie variable products offered by Jackson. In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product is funded under a separate account that is registered with the SEC as a unit investment trust.

JNAM is registered as a 'commodity pool operator' with the National Futures Association ('NFA') pursuant to Commodity Futures Trade Commission ('CFTC') regulations and is acting as a 'commodity pool operator' with respect to the operation of certain of the mutual funds. JNAM and the mutual funds have incurred additional regulatory compliance and reporting expenses as a result, which could reduce investment returns or harm the mutual fund's ability to implement its investment strategy.

Jackson National Life Distributors LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Jackson National Life Distributors LLC is a member firm of FINRA and is subject to FINRA's oversight and regulatory requirements.

National Planning Holdings, Inc. ('NPH') owned four retail broker dealers, including IFC Holdings, Inc. (doing business as INVEST Financial Corporation- 'INVEST'), Investment Centers of America, Inc ('ICA'), National Planning Corporation ('NPC') and SII Investments, Inc. ('SII'). These entities conducted business as securities broker-dealers, investment advisers, and insurance agencies (or affiliated with insurance agencies), and are licensed and qualified to transact business pursuant to their respective registration or

licensure with the SEC, state securities and insurance authorities, and membership with FINRA and the Municipal Securities Rulemaking Board. NPC, SII, and ICA are also registered with the CFTC as introducing brokers, and are members of the NFA for purposes of commodities and futures trading.

On August 15, 2017, NPH announced that it had entered into an asset purchase agreement by which it has sold the covered businesses of the NPH firms to LPL Financial, LLC ('LPL'). The registered representatives and client accounts affiliated with the NPH firms have or will transition to LPL in November 2017 (for NPC and ICA) and February 2018 (for IFC and SII). Thereafter, the NPH firms will cease business operations and deregister with its regulators.

Prudential also conducts certain of its US institutional investment management activities through PPM America, Inc. ('PPM America'), which is registered with the SEC as an investment adviser under the Investment Advisers Act. PPM America serves as the investment adviser to Jackson and as the primary US institutional investment adviser for certain Prudential subsidiaries, including The Prudential Assurance Company Limited, among others. PPM America also acts as investment sub-adviser to certain US and foreign advisers affiliated with Prudential primarily for US portfolios of accounts or products sponsored or managed by such affiliates, such as US mutual funds, a UK-based pooled investment vehicle, Japanese investment trusts, funds organised under Luxembourg-based SICAVs, a South Korean investment trust fund, and Taiwanese investment trust funds for which PPM America serves as investment consultant and dealing services agent. PPM America also serves as an investment adviser to other affiliated and unaffiliated institutional clients including private investment funds, a CDO and CLOs. PPM America is currently focussed on establishing an internal distribution function to further extend its investment advisory capabilities to the institutional marketplace with separate account and institutional product offerings. The US mutual funds for which PPM America serves as adviser and sub-adviser are subject to regulation under the Securities Act and the Investment Company Act, and other similar vehicles organised outside of the US are also subject to regulation under applicable local law.

PPM America and certain of its subsidiaries are subject to various levels of regulation under federal and state securities laws that the SEC administers as well as state securities laws. In connection with providing investment advisory services to certain of its clients, PPM America may also be subject to regulation under applicable foreign laws.

To the extent that PPM America or the NPH broker-dealers manage accounts with assets of employee benefit plans, individual retirement accounts ('IRAs') or similar qualified accounts subject to the Employee Retirement Income Security Act of 1974 ('ERISA'), or the Internal Revenue Code, they may be subject to certain restrictions imposed by ERISA or the Internal Revenue Code. Such restrictions are summarised in 'Employee Benefit Plan Compliance' in the section below. The US Department of Labor ('DOL') and the IRS have interpretive and enforcement authority over the applicable provisions of ERISA and the Internal Revenue Code.

Disclosure obligations under the US Securities Exchange Act and in particular under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012

Under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, which added Section 13(r) of the Securities Exchange Act of 1934, Prudential is required to disclose certain activities and those of its affiliates related to Iran and to persons sanctioned by the US under programs relating to terrorism, proliferation of weapons of mass destruction and trading with North Korea that occurred in the twelve-month period covered by this report.

Prudential's non-US affiliates have engaged in transactions with four persons sanctioned by the Office of Foreign Assets Control (OFAC) of the US Department of Treasury. These transactions were entered into in compliance with laws and regulations applicable to the relevant affiliates.

The first individual, designated pursuant to US Executive Order 13224, took out a one-off takaful certificate (a Shariah compliant life policy) with Prudential's Malaysian insurance subsidiary in October 2011. It was discovered in March 2012 through automated checking that his name matched various sanctions lists. The policy premium has been increased to RM625 per month from RM600 per month starting October 2017 resulting from internal product re-pricing and RM 7,275 was paid for up to December 2017 (equivalent to around US$150 and US$1,750, respectively). The matter was reported to the Malaysian government AML and sanctions regulatory authority, the Bank Negara Malaysia Financial Intelligence Unit, in March 2012. Currently, the said policy has been frozen with no top-up, withdrawal or claims permitted, although regular premium payment is still allowed in Malaysian Ringgit. The policy is in force, with no claims submitted or any outward payments made to date.

The second individual, also designated pursuant to US Executive Order 13224, is a beneficiary of three life insurance policies in his wife's name, the first taken out in December 2010 and two others taken out in November 2011 with Prudential's Indonesian insurance subsidiary. The annual premium of the three life insurance policies is IDR 6,000,000 (approximately US$444), IDR 12,000,000 (US$888) and IDR 12,000,000 (US$ 888), respectively. The matter was notified to the Indonesian governmental sanctions authority, the PPATK, in August 2012. All three policies remain in force and annual premiums are being funded by the policies' cash value. As such, there have been no premiums received and there have also been no claims or other outward payments in 2017.

The third individual, designated on 26 September 2016 pursuant to US Executive Order 13382 took out three life insurance policies between 2010 and 2013 with Prudential's Hong Kong insurance subsidiary. The matter was discovered during the periodic customer sanctions screening in December 2016 and due to the nature of the designation the client relationship was also reported to the Hong Kong Joint Financial Intelligence Unit. The annual premium of the three life insurance policies is US$10,309, HKD4,880 (approximately US$625) and HKD11,789 (approximately US$1,510). There have been no premiums received since and there have also been no claims or other outward payments since the OFAC designation. One of the three policies has lapsed and the other two policies remain in force and are being funded by the policies' cash value.

The fourth individual, designated on 22 August 2017 pursuant to US Executive Order 13722 took out one insurance policy with Prudential's Hong Kong insurance subsidiary in September 2016 with an annual premium of US$12,927. The case was discovered in September 2017 during the periodic customer sanctions screening. The client relationship was reported to the Hong Kong Joint Financial Intelligence Unit. There have been no premiums received and there have also been no claims or other outward payments since policy inception. The policy remains in force and is being funded by the policy cash value.

As the provisioning of insurance liabilities is undertaken on a portfolio basis, it is not practical to estimate the 2016 net profits on the contracts referred to above.

Prudential does not intend to engage in further new business dealings with these individuals.

In the UK, The Prudential Assurance Company Limited operates a pension scheme for employees of the UK branch of government-owned Iranian bank. A total of 36 scheme members are receiving benefits, with 27 deferred members. All members are inactive in that no member contributions are being made.

The scheme is closed to new members. Due to the long term nature of a pension scheme it is not practical to advise the net profit, but the fund value at 31 December 2017 stood at £7,830,627. In return for administering the scheme there are standard Prudential scheme charges: an annual fee of £751, plus £11 per member, £61 per quote and a Trustee Accounts charge (£1,944).

The annual invoice paid on 14 September 2017 was for £3,762 (£751 scheme fee, £396 member fees, £671 fees on quotes and £1,944 Trustee Accounts). In addition to this an Annual Management Charge of 1.25 per cent is reflected in the fund value.

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The UK governmental sanctions authority, Office of Financial Sanctions Implementation (OFSI), has been informed of this arrangement and in 2008 advised Prudential that following an analysis of the deeds, the fund is not owned, held or controlled by the Iranian bank. Payments out of the fund have been approved by OFSI through a licence. The trustees of the scheme have indicated that they may want to wind up the scheme, in which case, the existing members of the scheme may be provided with their own personal pension plans with us and we would deal with them as individual customers.

Employee benefit plan compliance

Jackson issues certain types of general account stable value products, such as Guaranteed Investment Contract ('GICs') and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. Many of 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, Jackson may be subject to certain fiduciary and prohibited transaction rules imposed by ERISA and taxes imposed by the Internal Revenue Code if Jackson violates those rules. The DOL and the IRS have interpretive and enforcement authority over the applicable 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 plan's assets include the policy and do not include the insurer's underlying assets. Accordingly, the insurer does 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 a portion of the funds held under a certain type of general account annuity contract did not constitute a 'guaranteed benefit policy' within the meaning of ERISA, a holding which potentially exposes insurers with similar types of contracts to the application of ERISA's fiduciary and prohibited transaction provisions in connection with the management of plan assets in their general accounts.

Although no assurances can be given, Jackson believes that none of its contracts are of the type to which the Harris Trust ruling would be applicable. Moreover, the DOL has issued Prohibited Transaction Exemption 95-60, which generally exempts external, unaffiliated investment transactions from ERISA's prohibited transaction provisions. If the Harris Trust ruling is applied to its contracts, the Jackson contracts covered by the Harris Trust Ruling would be subject to ERISA's fiduciary and prohibited transaction provisions described above.

The DOL released a final version of its fiduciary rule in April 2016, with initial application from April 2017 (which was extended to June 2017) and partial implementation in January 2018. The effective date of the remaining portions of the rule was delayed until 1 July, 2019. On 15 March 2018, the U.S. Court of Appeals for the Fifth Circuit in a 2-1 decision vacated the fiduciary rule. The Rule as written, would have subjected many advisers who work with qualified retirement plans and Individual Retirement Accounts to certain of the fiduciary requirements of ERISA, including obligations to avoid conflicts of interest. Those conflict of interest rules may be incompatible with many compensation structures that have historically been permissible and resulted in product and distribution changes throughout the industry. The DOL can appeal the Fifth Circuit decision.

Jackson has implemented changes necessary to meet the requirements of the sections of the fiduciary rules which are effective. Jackson has made and continues to consider changes to its product offerings and is working with its distributors to support implementation of the Best Interest Contract Exemption or product changes to the extent those become necessary before June 2019.

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Financial services regulatory and legislative issues

The Dodd-Frank Wall Street Reform and Consumer Protection Act ('Dodd-Frank Act'), which represents a comprehensive overhaul of the financial services industry within the US, was enacted in July 2010. While the majority of the Dodd-Frank Act has been met with finalised rules, it is possible that is and/or the rules promulgated pursuant to it will be repealed, reversed, or otherwise limited if the Financial Choice Act is passed by the US Congress. It is unclear, however, whether any meaningful change is forthcoming given other priorities facing Congress and the current administration. The impact of Dodd Frank on Jackson and Prudential operations is minimal.

The Dodd-Frank Act also established the Federal Insurance Office ('FIO'). The FIO has no direct regulatory authority over US insurers, but it does have certain authority to represent the US government on prudential aspects of international insurance matters, including at the IAIS. The FIO is also authorised to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry.

The Dodd-Frank Act vests the Financial Stability Oversight Council (the 'Council') with the power to designate domestic systemically important non-bank institutions which will be subject to special regulatory supervision and other provisions intended to prevent or mitigate the impact of future disruptions in the US financial system. If Jackson is designated in the US as a systemically important non-bank institution, it may be subject to heightened prudential standards to be administered by the US Federal Reserve Board, including heightened capital, leverage and liquidity standards, risk management requirements, single counterparty credit concentration limits, resolution plans and stress tests, and potential discretionary requirements relating to contingent capital, enhanced public disclosure and short term debt limits. As discussed under the Global Regulatory Developments and trends section, Prudential Group was designated as a G-SII in July 2013, which is separate from a Dodd-Frank designation.

Dodd-Frank Act rules and guidance outlining the manner in which the Council will determine which companies should be so designated in the US were adopted in April 2012. The rules set forth a three-stage process of increasingly in-depth evaluation and analysis, drawing on both qualitative and quantitative information (but preserving significant Council discretion). Section 113 of Dodd-Frank authorises the Financial Stability Oversight Council (FSOC) to designate a non-bank financial company to be subject to supervision by the Federal Reserve and enhanced prudential standards if the company's material financial distress or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities could pose a threat to U.S. financial stability. Three of the four companies initially designated by the FSOC under Section 113 were insurers. AIG and Prudential Financial were designated by the FSOC in 2013; MetLife was designated in 2014. In March 2016, a federal court order rescinded the FSOC designation of MetLife, which has been appealed by the FSOC and remains pending. In September 2017, the FSOC announced that it rescinded the designation of AIG.

In addition, Title VII of the Dodd-Frank Act created a new regulatory regime for certain derivatives called swaps and security-based swaps. Prudential and Jackson have determined that they are not required to register as swap dealers, security-based swap dealers, major swap participants, or major security-based swap participants under Title VII of the Dodd-Frank Act. However, CFTC regulations requiring that swaps be reported to trade repositories and, in some cases, cleared through registered central counterparties and traded on registered exchanges may apply to certain derivatives entered into by Jackson and, in some circumstances, Prudential. Similar rules for security-based swaps have been proposed, and in some cases finalised, but not yet implemented.

Under Title VII of the Dodd-Frank Act, certain derivatives instruments, including standardised interest rate swaps and index credit default swaps, are required to be cleared and traded on an exchange. While the transition to exchange-traded derivative instruments may limit counterparty risk, it may increase costs associated with such investments, including transaction and exchange fees. The standardisation of exchange-traded derivative instruments may also limit the ability of Jackson and the mutual funds to

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customise certain derivative instruments with their counterparties. Exchange-traded derivative instruments may also require Jackson and the mutual funds to post additional collateral or limit the types of collateral that may be used for such transactions. Variation margin requirements for uncleared swaps are now fully effective for all market participants, including Jackson and the mutual funds while initial margin requirements for these market participants will be phased in through September 2020, based on the notional amount of the participant's uncleared swaps. These developments may limit the ability of Jackson and the mutual funds that its subsidiaries advise to effectively deploy assets in a timely manner.

The timing and the ultimate impact on the management and operations of Prudential and the regulations promulgated, or to be promulgated, pursuant to these statutory provisions, cannot yet be definitively determined.

Proposals to change the laws and regulations governing the financial services industry are frequently introduced in the US Congress, in the state legislatures and before the various regulatory agencies. Recently, these include fiduciary or other standards of conduct under the DoL Rule, possible proposals by the SEC to define standards of conduct applicable to investment advisers and broker-dealers when they provide investment advice to retail investors, and proposals by various states to impose fiduciary obligations on brokers and insurance agents. The likelihood and timing of any proposals or legislation, and the impact they might have on Jackson, its subsidiaries, or other Prudential subsidiaries doing business in the US, cannot be determined at this time.

State legislatures and/or state insurance regulatory authorities frequently enact laws and/or regulations that significantly affect insurers supervised by such authorities. Although the US federal government does not directly regulate the insurance business, federal initiatives may also have an impact on the insurance industry. State insurance regulators, the NAIC and other regulatory bodies regularly reexamine existing laws and regulations applicable to insurance companies and their products.

Federal and state regulators have focused on the mutual fund and variable annuity and insurance product industries including the broker-dealer system. As a result of publicity relating to widespread perceptions of industry abuses, including fraudulent and anti-competitive practices among insurance brokers and mutual funds, there have been numerous regulatory inquiries and proposals for legislative and regulatory actions that could affect the operations and management of market participants. In addition, the SEC has implemented a data analytics review process, and periodically makes data requests from registered entities. It is difficult to predict at this time whether changes resulting from industry investigations and/or new laws and regulations will affect the Group's insurance or investment management businesses, and, if so, to what degree.

US tax reform

On 22 December 2017, a significant US tax reform package, The Tax Cuts and Jobs Act, was enacted into law effective from 1 January 2018. The tax reform package as a whole, which includes a reduction in the tax rate from 35 per cent to 21 per cent and a number of specific measures affecting US life insurers, is expected to be beneficial in the longer term. The 2017 impact resulted in a decrease of US$ 810 million (£628 million) to Jackson's statutory total adjusted capital. The impact on the Group's IFRS income statement and on other comprehensive income of the US tax changes are set out in notes B4 and C8 to the consolidated financial statements.

Additional jurisdictions

The Group has also invested in businesses located in various other markets. The Group has operations in Poland, Ireland, Myanmar, Ghana, Kenya, Uganda, Zambia and Nigeria.

These developments and such incremental regulation remain immaterial at present in terms of the overall business of the Group.

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GOVERNANCE

Introduction

This report provides an explanation of the Group's governance arrangements and its activities in this area during 2017.

Good governance encourages decisions to be made in the best interests of the business, taking account of the views of stakeholders. We aim to achieve this through a responsive governance framework that supports and challenges our executives' decision making.

Effective leadership

One of the Chairman's priorities is how the Board can improve and work together even more effectively. The Board undertakes an annual review of its performance, both collectively and as individuals and uses the outcomes of these reviews to drive improvements over the coming year. The actions taken by the Board in 2017 to address the recommendations of the 2016 review are set out in the How We Operate section of this report. An external independent evaluation was conducted at the end of 2017 in order to provide shareholders with further comfort that the Board continues to operate effectively. Details of the 2017 review can be found in the How We Operate section. The review concluded that the Board's strengths included "strong leadership in a collegiate and constructive environment", "effective use of time and materials", and "strong risk and control oversight".

2017 has seen a refresh of the Board in both Non-executive and Executive roles. The changes to the Board have highlighted the strength of its succession planning activities which have allowed it to successfully navigate a number of changes without disruption. This planning has enabled the Board to recruit very high calibre candidates to the Board, with diverse skills and expertise. Succession planning has therefore been a particular area of focus during the year and the Board will continue to keep this under active review. The activities of the Nomination & Governance Committee in this respect are set out in the Governance Committees section and all changes to the Board are set out in the Board of Directors section of this report.

Risk and internal controls

Fundamental to demonstrating good governance and stewardship is having in place processes to allow the Board to make a robust assessment of the risks facing the business and those internal controls used to mitigate them. Details of the Board's approach to internal controls and risk management are set out in this report. The Audit Committee report in the Governance Committees section describes how the Committee monitors the effectiveness of the internal control and risk management systems and the Risk Committee report in the Governance Committees section sets out how that Committee has considered the Group's risk appetite.

Culture

Prudential believes that tone is set from the top and the Board and senior management must therefore exhibit the behaviours expected throughout the Group. Individual businesses are also shaping culture locally, contributing to the shared values of the Group. Under the Chairman's stewardship, the international volunteering programme, Chairman's Challenge, has grown significantly and over 8,000 colleagues offered their time and skills to supporting the community in 2017.

The Board has set itself an objective for the Group to develop a framework for a measureable, definable culture. As part of this, a risk culture survey was developed by the Risk Committee covering all businesses. The Board will continue to build on this in 2018, bringing together the many strands of initiatives around the Group.

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In December, the Board approved an updated Group Code of Conduct which introduced standards of business conduct. This clarifies expectations over employee behaviour and seeks to ensure employees understand the individual obligations that the Group imposes on them through its policies, including financial crime prevention, conflicts of interest, information security and securities dealing, public communications and social media, people related policies and confidential reporting.

Strategic projects

In 2017, the Board considered a number of strategic projects. Most notably, it announced in August 2017 the intention to merge the Group's UK asset manager, M&G, and its UK life insurance business to form M&G Prudential. The combined business manages over £330 billion in assets for more than six million customers. Further details of the merger are set out in the Strategic report. From a governance perspective, the Board and Audit Committee spent significant time considering the benefits of the transaction for shareholders and customers and the impact on its wider stakeholders.

During the year the Board also announced the sale of its broker-dealer network in the US, which was owned by its subsidiary National Planning Holdings Inc. and consisted of INVEST Financial Corporation, Investment Centres of America, Inc, National Planning Corporation and SII Investments, Inc., to LPL Financial LLC. This allows the Board to focus on its primary strategy in North America of being the leading manufacturer of retirement products.

Looking after our stakeholders

The Board continues to be aware of the impact of its decisions on all of its stakeholders. Feedback received from engaging with stakeholders helps the Board to devise and manage policies and processes.

In 2017, the Group published its first environmental, social and governance (ESG) report which gave a detailed account of its approach to ESG matters. That report explains that while serving customers is at the centre of the Group's business, other stakeholders are approached with the same sense of responsibility and commitment, from the suppliers and employees to the wider communities in which the Group operates. The Board expects to publish its next ESG report in May 2018.

Looking forward

On the governance front, of key interest will be the changes proposed to the UK Corporate Governance Code, which are set to include a range of new requirements for both behaviour and reporting. Once in place, the Board and its Committees will consider how any changes will affect the way the Board works.

On a regulatory level, the impact of International Financial Reporting Standard 17 (IFRS 17) on the Group will be further assessed following work already undertaken by the Board and Audit Committee.

Board of Directors

The Prudential Board consists of 16 directors as at 22 March 2018.

Set forth below are the names, ages, positions, business experience and principal business activities performed by the current Directors, as well as the dates of their initial appointment to the Prudential Board. This includes those Directors who joined the Board up to the date of filing. Ages are given at 22 March 2018.

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Board of Directors

Paul Manduca	**Relevant skills and experience**	**Other appointments**
Chairman **Appointment:** October 2010 **Committees:** Nomination & Governance (Chair) **Age:** 66	Paul has held a number of senior leadership roles. Notable appointments include serving as chairman of the Association of Investment Companies (1991 to 1993), acting as founding CEO of Threadneedle Asset Management Limited (1994 to 1999), directorships of Eagle Star and Allied Dunbar, holding the offices of European CEO of Deutsche Asset Management (2002 to 2005), global CEO of Rothschild Asset Management (1999 to 2002), chairman of Bridgewell Group plc and a director of Henderson Smaller Companies Investment Trust plc. Other previous appointments include the chairmanship of Aon UK Limited and JPM European Smaller Companies Investment Trust Plc. From September 2005 until March 2011, Paul was a non-executive director of Wm Morrison Supermarkets Plc, including as senior independent director, audit committee chairman and remuneration committee chairman. He was also a non-executive director and audit committee chairman of KazMunaiGas Exploration & Production until the end of September 2012. During 2017, Paul stepped down as chairman and as a member of the board of Henderson Diversified Income Limited with effect from 26 April 2017 and was appointed to the board of RateSetter (Retail Money Market Limited) with effect from 1 June and as chairman from 17 July. Paul initially joined the Board in October 2010 as the Senior Independent Director and member of the Audit and Remuneration Committees, roles he held until his appointment as Chairman in July 2012. On becoming Chairman, Paul was also appointed Chair of the Nomination & Governance Committee, having been a member of the Committee since January 2011.	Securities Institute Rate Setter (Retail Money Market Limited) (chairman) Templeton Emerging Markets Investment Trust (TEMIT) (chairman) TheCityUK advisory council

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Michael Wells	**Relevant skills and experience**
Group Chief Executive **Appointment:** January 2011 **Age:** 57	Mike has more than three decades' experience in insurance and retirement services, having started his career at the US brokerage house Dean Witter, before going on to become a managing director at Smith Barney Shearson. Mike joined the Prudential Group in 1995 and became Chief Operating Officer and Vice-Chairman of Jackson in 2003. In 2011, he was appointed President and Chief Executive Officer of Jackson, and joined the Board of Prudential. During his leadership of Jackson, Mike was responsible for the development of Jackson's market-leading range of retirement solutions. He was also part of the Jackson teams that purchased and successfully integrated a savings institute and two life companies. Mike joined the Board in 2011 and was appointed Group Chief Executive in June 2015.

Executive Directors

Mark FitzPatrick CA	**Relevant skills and experience**
Chief Financial Officer **Appointment:** July 2017 **Age:** 49	Mark previously worked at Deloitte for 26 years, building his industry focus on insurance and investment management globally. During this time, Mark was Managing Partner for Clients and Markets, a member of the executive committee and a member of the board of Deloitte UK. He was a vice chairman of Deloitte for four years, leading the CFO Programme and developing the CFO Transition labs. Mark previously led the Insurance & Investment Management audit practice and the insurance industry practice. Mark joined the Board as an Executive Director and Chief Financial Officer in July 2017.

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John Foley

Chief Executive of M&G Prudential

Appointment: January 2016

Age: 61

Relevant skills and experience

John spent over 20 years at Hill Samuel & Co, where he worked in every division of the bank, culminating in senior roles in risk, capital markets and treasury of the combined TSB and Hill Samuel Bank. Before joining Prudential, John spent three years as general manager, global capital markets at National Australia Bank.

John joined Prudential as Deputy Group Treasurer in 2000 and became Managing Director of Prudential Capital and Group Treasurer in 2001. During his career at Prudential, John has held the offices of Chief Executive of Prudential Capital, Group Chief Risk Officer, Group Investment Director and Chief Executive of Prudential UK & Europe.

John first joined the Board in 2011 as Group Chief Risk Officer and was reappointed in January 2016, having stepped down during his time as Group Investment Director.

In 2017, John's role was expanded from Chief Executive of Prudential UK & Europe to Chief Executive of M&G Prudential, the Group's combined UK asset management and savings and retirement solutions business.

Nicolaos Nicandrou ACA

Chief Executive of Prudential Corporation Asia

Appointment: October 2009

Age: 52

Relevant skills and experience

Nic started his career at PricewaterhouseCoopers. Before joining Prudential, he worked at Aviva, where he held a number of senior finance roles, including Norwich Union Life finance director and board member, Aviva group financial control director, Aviva group financial management and reporting director and CGNU group financial reporting director.

In July 2017, Nic became Chief Executive of Prudential Corporation Asia having originally joined the Board in October 2009 as an Executive Director and Chief Financial Officer.

Other appointments

European Insurance CFO Forum (chairman)

CITIC-Prudential Life Insurance Company Limited (a Prudential plc joint venture)

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Anne Richards Deputy Chief Executive of M&G Prudential and Chief Executive of M&G **Appointment:** June 2016 **Age:** 53	**Relevant skills and experience** Anne became an analyst for Alliance Capital in 1992 and then moved into portfolio management roles at JP Morgan Investment Management and Mercury Asset Management. She joined the board of Edinburgh Fund Managers plc as chief investment officer and joint managing director in 2002 and continued in this role following Aberdeen Asset Management PLC's acquisition of Edinburgh Fund Managers in 2003. Anne was chief investment officer and head of the EMEA region for Aberdeen Asset Management PLC, positions she held until February 2016. Anne joined the Board in 2016 as an Executive Director and Chief Executive of M&G. She became Deputy Chief Executive of M&G Prudential in 2017 whilst remaining Chief Executive of M&G.	**Other appointments** Financial Services advisory board CFA UK Advisory Financial Conduct Authority practitioner panel (chair) Standing Council on Europe IBDE advisory board
Barry Stowe Chairman and Chief Executive Officer of the North American Business Unit **Appointment:** November 2006 **Age:** 60	**Relevant skills and experience** Before joining Prudential, Barry was president, accident & health worldwide for AIG Life Companies. He joined AIG in 1995 after having held senior positions at Pan-American Life and Willis in the United States. Barry joined the Board in 2006 as an Executive Director and the Chief Executive of Prudential Corporation Asia, leading Prudential's Asian business through a period of major growth and development. Barry fulfilled this role until June 2015 when he became Chairman and Chief Executive of the North American Business Unit.	**Other appointments** International Insurance Society American Council of Life Insurers

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Non-executive Directors

The Hon. Philip Remnant CBE FCA Senior Independent Director **Appointment:** January 2013 **Committees:** Audit, Remuneration, Nomination & Governance **Age:** 63	**Relevant skills and experience** Philip was a senior advisor at Credit Suisse and a vice chairman of Credit Suisse First Boston (CSFB) Europe and head of the UK Investment Banking Department. He was twice seconded to the role of director general of the Takeover Panel. Philip also served on the board of Northern Rock plc and as chairman of the Shareholder Executive. Philip joined the Board in January 2013 as a Non-executive Director, as Senior Independent Director and as a member of each of the Audit Committee, the Remuneration Committee and the Nomination & Governance Committee.	**Other appointments** City of London Investment Trust (chairman) M&G Group Limited (Prudential plc subsidiary) (chairman) Severn Trent plc Takeover Panel UK Financial Investments Limited
Sir Howard Davies **Appointment:** October 2010 **Committees**: Risk (Chair), Audit, Nomination & Governance **Age:** 67	**Relevant skills and experience** Sir Howard has a wealth of experience in the financial services industry, across the Civil Service, consultancy, asset management, regulatory and academia. Sir Howard was previously chairman of the Phoenix Group and an independent director of Morgan Stanley Inc. Sir Howard joined the Board in October 2010 as a Non-executive Director and Chair of the Risk Committee. He joined the Audit Committee in November 2010 and the Nomination & Governance Committee in July 2012.	**Other appointments** China Banking Regulatory Commission international advisory board China Securities Regulatory Commission international advisory board (chairman) Institut d'Études Politiques (Sciences Po) Millennium LLC regulatory advisory board

Royal Bank of Scotland (chairman)

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David Law ACA **Appointment:** September 2015 **Committees:** Audit (Chair), Risk, Nomination & Governance **Age:** 57	**Relevant skills and experience** David was the Global Leader of PricewaterhouseCoopers (PwC) insurance practice, a partner in PwC's UK firm, and worked as the lead audit partner for multi-national insurance companies until his retirement in 2015. David has also been responsible for PwC's insurance and investment management assurance practice in London and the firm's Scottish assurance division. David joined the Board in September 2015 as a Non-executive Director and member of the Audit Committee. David was appointed Chair of the Audit Committee and a member of the Risk Committee and of the Nomination & Governance Committee in May 2017.	**Other appointments** L&F Holdings Limited (CEO) and its subsidiaries (the professional indemnity captive insurance group that serves the PwC network and its member firms)
Kaikhushru Nargolwala FCA **Appointment:** January 2012 **Committees:** Risk, Remuneration **Age:** 67	**Relevant skills and experience** Kai spent 19 years at Bank of America and was based in Hong Kong in roles as group executive vice president and head of the Asia Wholesale Banking Group during 1990 to 1995. He spent 10 years working for Standard Chartered PLC in Singapore as group executive director responsible for Asia Governance and Risk during 1998 to 2007. Kai was chief executive officer of the Asia Pacific Region of Credit Suisse AG during 2008 to 2010 and now serves as director and chairman of their remuneration committee. Kai has served on a number of other boards, including Singapore Telecommunications and Tate and Lyle plc. Kai joined the Board in January 2012 as a Non-executive Director and member of the Remuneration and Risk Committees.	**Other appointments** Clifford Capital Pte. Ltd (chair) Credit Suisse Group AG Duke-NUS Medical School (chairman) Prudential Corporation Asia Limited (Prudential plc subsidiary) (chairman) PSA International Pte Ltd

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Anthony Nightingale CMG SBS JP **Appointment:** June 2013 **Committees:** Remuneration (Chair), Nomination & Governance **Age:** 70	**Relevant skills and experience** Anthony spent his career in Asia, where he joined the Jardine Matheson Group in 1969, holding a number of senior positions before joining the board of Jardine Matheson Holdings in 1994. He was managing director of the Jardine Matheson Group from 2006 to 2012. Anthony joined the Board in June 2013 as a Non-executive Director and member of the Remuneration Committee. He became Chair of the Remuneration Committee and a member of the Nomination & Governance Committee in May 2015.	**Other appointments** Jardine Matheson Holdings (and other Jardine Matheson group companies) Schindler Holding Limited Shui On Land Limited The Hong Kong-APEC trade policy study group (chairman) UK-ASEAN Business Council Vitasoy International Holdings Limited
Alice Schroeder **Appointment:** June 2013 **Committees:** Audit, Risk **Age:** 61	**Relevant skills and experience** Alice began her career as a qualified accountant at Ernst & Young. She joined the Financial Accounting Standards Board as a manager in 1991, overseeing the issuance of several significant insurance accounting standards. From 1993, she led teams of analysts specialising in property-casualty insurance as a managing director at CIBS Oppenheimer, PaineWebber (now UBS) and Morgan Stanley. Alice was also an independent board member of the Cetera Financial Group. Alice joined the Board in June 2013 as a Non-executive Director and member of the Audit Committee. She became a member of the Risk Committee in March 2018.	**Other appointments** Bank of America Merrill Lynch International Showfer Media LLC (formerly WebTuner Corp) (chair)

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Lord Turner FRS **Appointment:** September 2015 **Committees:** Audit, Risk **Age:** 62	**Relevant skills and experience** Lord Turner began his career with McKinsey & Co, advising companies across a range of industries. He served as director-general of the Confederation of British Industry, vice-chairman of Merrill Lynch Europe, chairman of the Pensions Commission and as a non-executive director of Standard Chartered Bank. Lord Turner was chairman of the UK's Financial Services Authority, a member of the international Financial Stability Board and a non-executive director of the Bank of England. Lord Turner joined the Board in September 2015 as a Non-executive Director and member of the Risk Committee. He became a member of the Audit Committee in May 2017.	**Other appointments** Chubb Europe (chairman) Energy Transition Commission (chairman) House of Lords crossbench member (from 2005) Institute for New Economic Thinking (chairman) London School of Economics and Cass Business School (visiting professor) OakNorth Bank (advisor)
Thomas Watjen **Appointment:** July 2017 **Committees:** Remuneration **Age:** 63	**Relevant skills and experience** Tom started his career at Aetna Life and Casualty before joining Conning & Company, an investment and asset management provider, where he became partner in the capital markets and venture capital division. He joined Morgan Stanley in 1987 as a managing director in its insurance practice and in 1994, was appointed executive vice president and chief financial officer of Provident Companies Inc. A key architect of Provident's merger with Unum in 1999, Tom was appointed president and chief executive officer of the renamed Unum Group in 2003, a role he held for 12 years before becoming non-executive chairman until his retirement in May 2017. Tom joined the Board in July 2017 as a Non-executive Director and member of the Remuneration Committee.	**Other appointments** SunTrust Banks, Inc

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Executive Director appointment post year end

James Turner FCA	**Relevant skills and experience**	**Other appointments**
Group Chief Risk Officer **Appointment:** March 2018 **Age:** 48	James led internal audit teams in UBS in both the UK and Switzerland. Prior to joining Prudential, James was the deputy head of compliance for Barclays plc. He also held a number of senior internal audit roles across the Barclays group, leading teams that covered the UK, the US, Western Europe, Africa and Asia retail and commercial banking activities. James joined Prudential in November 2010 as the Director of Group-wide Internal Audit and was appointed Director of Group Finance in September 2015, with responsibility for delivery of the Group's internal and external financial reporting, business planning, performance monitoring and capital and liquidity planning. He also led the development of the Group's Solvency II internal model. James joined the Board as an Executive Director and Group Chief Risk Officer in March 2018.	West Bromwich Building Society

Board changes

Non-executive Directors

Ann Godbehere retired from the Board at the conclusion of the Annual General Meeting held on 18 May 2017.

David Law succeeded Ms Godbehere as Chair of the Audit Committee and became a member of the Risk Committee and the Nomination & Governance Committee with effect from 19 May 2017. Lord Turner was appointed a member of the Audit Committee with effect from 19 May 2017.

Tom Watjen was appointed to the Board and as a member of the Remuneration Committee with effect from 11 July 2017.

Post year end, Alice Schroeder was appointed a member of the Risk Committee with effect from 1 March 2018.

Executive Directors

Tony Wilkey stepped down as a member of the Board and as Chief Executive of Prudential Corporation Asia and Nic Nicandrou succeeded him in this position. Mark FitzPatrick was appointed to the Board to succeed Mr Nicandrou as Chief Financial Officer. The effective date for these changes was 17 July 2017.

In August 2017, the Company announced its intention to merge its asset manager, M&G, and Prudential UK & Europe to form M&G Prudential. John Foley became Chief Executive of M&G Prudential and Anne Richards became Deputy Chief Executive of M&G Prudential (retaining her role as Chief Executive of M&G).

Penny James stepped down from the Board and as Chief Risk Officer with effect from 30 September 2017. James Turner was appointed as an Executive Director and as Group Chief Risk Officer with effect

from 1 March 2018. Pat Casey held the role of Group Chief Risk Officer on an interim basis until 1 March 2018.

Other Executive Officers

The name, business experience, functions and areas of experience of each of the Executive Directors and their biographical details are set out above.

For information relating to the compensation paid to all Prudential Directors see the section 'Compensation and Employees'.

BOARD PRACTICES

How we operate

How the Board leads the Group

The Group is headed by a Board which the Chairman is responsible for leading. A majority of Directors on the Board, excluding the Chairman, are independent Non-executive Directors. Biographical details of each of the Directors can be found in the Board of Directors section and further details of the roles of the Chairman, Group Chief Executive, Senior Independent Director, Committee Chairs and the Non-executive Directors can be found later in this section.

The Board is collectively responsible to shareholders for the success of the business through:

- The delivery of sustainable value to shareholders;
- Setting the Group's strategy and overall risk appetite;
- Providing leadership within a framework of effective controls; and
- Monitoring management's performance against strategic goals and ensuring sufficient resources are in place to achieve these goals.

Specific matters are reserved for decision by the Board, including: Determination of dividends;

- Approval of strategic projects;
- Approval of the three year business and financial plan;
- Approval of key financial reporting including the Group's full and half yearly Report and Accounts; and
- Responsibility for the system of internal control and risk management In making decisions, the Board has regard to the balance of interests between all relevant stakeholders, including shareholders, employees, customers, regulators and the community.

Our governance framework

The Group has established a governance framework for the business which is designed to promote appropriate behaviours across the Group.

The governance framework outlines the key mechanisms through which the Group sets strategy, plans its objectives, monitors performance, considers risk management, holds business units to account for delivering on business plans and arranges governance. The Group Governance Manual (the Manual) sets out the policies and procedures by which the Group operates within this framework, taking into account relevant statutory, regulatory and governance matters.

Business units manage and report compliance with Group-wide mandatory requirements set out in the Manual through their Governance, Risk Management and Internal Control Annual Statement of Compliance attestations. This includes compliance with our risk management framework, details of which are set out on pages later in this section.

The content of the Manual is reviewed regularly with significant changes reported to the relevant Board Committee, reflecting the developing nature of both the Group and the markets in which it operates.

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Material Subsidiary governance

Material Subsidiaries

Jackson National Life Insurance Company

M&G Group Limited

Prudential Corporation Asia Limited

The Prudential Assurance Company Limited

Prudential has appointed independent non-executive directors to the boards of its four Material Subsidiary entities within the Group. Each Material Subsidiary has a board of directors led by an independent chair and an audit committee and risk committee, composed entirely of independent non-executives. Dialogue between the Group Chair, Group Risk Committee Chair and Group Audit Committee Chair and their counterparts in the Material Subsidiaries provides an effective information flow.

An externally facilitated evaluation of each Material Subsidiary board and their audit and risk committees was carried out by Lintstock Limited, a corporate advisory firm, which concluded that each of those boards and committees operated effectively during the year.

The Nomination & Governance Committee is responsible for oversight of governance arrangements for the Material Subsidiaries. The activities of the Nomination & Governance Committee during 2017 is set out in the committee reports section.

Independent scrutiny of corporate social responsibility actions

As part of the Group's focus on corporate responsibility, the Chairman has instructed the boards of our Material Subsidiaries to consider updates on corporate responsibility activities and spend in their communities on an annual basis. This initiative has added a layer of independent scrutiny and helped to ensure that those boards are close to the community and charitable activities of their business units.

Regulatory environment

The Group's business means it is subject to regulatory requirements and oversight. The Group's primary regulator is the Prudential Regulatory Authority (PRA). We are also regulated by the Financial Conduct Authority in the UK and by other regulators worldwide.

Interactions with our regulators shape our governance framework and the Chairman and Group Chief Executive play a leading role in representing the Group to regulators and ensuring our dialogue with them is constructive.

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Board roles and governance

Chairman Paul Manduca

The Chairman is responsible for the leadership and governance of the Board, ensuring its smooth and effective running in discharging its responsibilities to the Group's stakeholders and managing Board business.

Managing Board business

Responsible for setting the Board agenda, ensuring the right issues are brought to the Board's attention through collaboration with the Group Chief Executive and the Group General Counsel and Company Secretary

Facilitating open, honest and constructive debate among Directors. When chairing meetings, ensuring there is sufficient time to consider all topics, all views are heard and all Board members, and in particular Non-executive Directors, have an opportunity to constructively challenge management

Meeting with Non-executive Directors throughout the year. In 2017, the Chairman met with Non-executive Directors without Executive Directors being present on three occasions

Ensuring information brought to the Board is accurate, clear, timely and contains sufficient analysis appropriate to the scale and nature of the decisions to be made

Promoting effective reporting of Board Committee business at Board meetings through regular Committee Chair updates

Membership and composition of the Board

Leading the Nomination & Governance Committee in succession planning and the identification of potential candidates, having regard to the skills and experience the Board needs to fulfil its strategy, and making recommendations to the Board

Considering the development needs of the Directors so that Directors continually update their skills and knowledge required to fulfil their duties, including the provision of a comprehensive induction for new Directors

Maintaining an effective dialogue with the Non-executive Directors to encourage engagement and maximise their contributions

Governance

Leading the Board's determination of appropriate corporate governance and business values, including ethos, values and culture at Board level and throughout the Group

Working with the Group General Counsel and Company Secretary to ensure continued good governance

Acting as key contact for independent chairs of Material Subsidiaries

Meeting with the independent chairs of the Group's Material Subsidiaries on a regular basis and reporting to the Board on the outcome of those meetings

Relationship with the Group Chief Executive

Discussing broad strategic plans with the Group Chief Executive prior to submission to the Board	Ensuring the Board is aware of the necessary resources to achieve the strategic plan
	Providing support and advice to the Group Chief Executive

Representing the Group externally to shareholders and other stakeholders

Representing the Board externally at business, political and community level. Presenting the Group's views and positions as determined by the Board	Balancing the interests of different categories of stakeholders, preserving an independent view and ensuring effective communication
Playing a major role in the Group's engagement with regulators	Engaging in a programme of meetings with key shareholders throughout the year and reporting to the Board on the issues raised at those meetings

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Group Chief Executive Mike Wells

The Group Chief Executive leads the Executive Directors and senior executives and is responsible for the operational management of the Group on behalf of the Board on a day-to-day basis:

Responsible for the implementation of Board decisions

Establishes processes to ensure operations are compliant with regulatory requirements

Sets policies, provides day-to-day leadership and makes decisions on matters affecting the operation, performance and strategy of the Group, seeking Board approval for matters reserved to the Board

Supported by the Group Executive Committee (GEC) which he chairs and which receives reports on performance and implementation of strategy for each business unit and discusses major projects and other activities related to the attainment of strategy

Chairs the Chief Executive's Committee (CEC) meetings which are held weekly to review matters requiring approval under the Group's framework of delegated authorities

Keeps in regular contact with the Chairman and briefs him on key issues

Meets with key regulators worldwide

Senior Independent Director Philip Remnant

The Senior Independent Director acts as an alternative conduit to the Board for shareholder concerns and leads the evaluation of the Chairman:

Keeps in close contact with the Chairman and acts as sounding board for him

Leads the Non-executive Directors in conducting the Chairman's annual evaluation

Holds meetings with Non-executive Directors without management being present, typically at least once a year to evaluate the performance of the Chairman

Offers meetings to major shareholders to provide them with an additional communication point on request and is generally available to any shareholder to address concerns not resolved through normal channels

Committee Chairs

Each of the Committee Chairs is responsible for the effective operation of their respective Committees:

Non-executive Directors

All of the Non-executive Directors are deemed to be independent and together have a wide range of experience used to attain the strategic aims of the Group through:

Responsible for the leadership and governance of their Committee	Constructive and effective challenge
Sets the agenda for Committee meetings	Scrutinising the performance of management in meeting agreed goals and objectives
Reports to the Board on the activities of each Committee meeting and the business considered, including, where appropriate, seeking Board approval for actions in accordance with the Committees' terms of reference	Serving on at least one of the Board's principal Committees
Works with the Group General Counsel and Company Secretary to ensure the continued good governance of each Committee during the year	Engaging with Executive Directors and management at Board and Committee meetings as well as at site visits, training sessions and on an informal basis
The Chairs of the Audit and Risk Committees act as key contact points for the independent chairs of the audit and risk committees of the Material Subsidiaries	Taking part in one-to-one meetings with the Group Strategy team and participation in the annual Strategy Away Day

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The Board has established four principal Committees whose functions are summarised below.

Board

Nomination & Governance Committee	Audit Committee	Risk Committee	Remuneration Committee
Chair Paul Manduca	Chair David Law	Chair Howard Davies	Chair Anthony Nightingale
Responsible for reviewing, maintaining and enhancing the balance of skills and experience on the Board in support of the Group's strategic objectives	Responsible for the integrity of the Group's financial reporting, including scrutinising accounting policies	Leads on and oversees the Group's overall risk appetite, risk tolerance and strategy	Recommends the Directors' Remuneration Policy for approval by shareholders
Maintains an effective framework for senior succession planning including at Board level	Monitors the effectiveness of internal control and risk management systems, including compliance arrangements	Approves the Group's risk management framework and monitors its effectiveness	Approves individual remuneration packages of the Chairman, the Executive Directors, other senior executives and the non-executive directors of Material Subsidiaries
Recommends appointments to the Board and its principal Committees and appointments of non-executive chairs to the boards of the Material Subsidiaries	Monitors the effectiveness and objectivity of internal and external auditors	Supports the Board and management in embedding and maintaining a supportive culture in relation to the management of risk	Determines the overall Remuneration Policy for the Group
Oversees the governance of Material Subsidiaries and the Group's overall governance framework	Approves the internal audit plan and recommends the appointment of the external auditor	Provides advice to the Remuneration Committee on risk management considerations to inform remuneration decisions	Reviews the design and development of share plans and approves and assesses performance targets where applicable
See Nomination & Governance Committee report later in this section.	See Audit Committee report later in this section.	See Risk Committee report later in this section.	See Remuneration Committee report later in this section.

The roles and responsibilities of each Committee are set out in their terms of reference which are reviewed by each Committee and approved by the Board on an annual basis.

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Key areas of focus how the Board spent its time

The Board held 10 meetings during 2017. In addition to those meetings set out in the table below, the Board held a separate three day strategy event in June. In addition to meetings, the Board receives monthly update reports from management.

	Feb	Mar(1)	May	Jun	Jul	Aug	Sep	Nov	Dec
Strategy and implementation									
approval and review of strategic priorities	•								
strategic priorities monitoring			•		•		•		•
approval of three year operating plan									•
strategic projects[2]			•		•	•	•	•	•
tax strategy reporting			•						
Group Chief Executive's report	•		•		•		•	•	•
Report from Committee Chairs									
Audit	•	•	•		•	•		•	•
Nomination & Governance	•			•				•	
Remuneration	•	•		•			•		•
Risk	•		•		•			•	•
Financial reporting and dividends									
Chief Financial Officer's performance report	•		•		•		•	•	•
full year	•	•							
half year					•	•			
Group Solvency II reporting	•		•						
Business unit Chief Executive updates									
Prudential Corporation Asia	•		•		•		•	•	•
North American business unit	•		•		•		•	•	•
M&G Prudential[3]	•		•		•		•	•	•
Risk, regulatory and compliance									
regulatory and compliance updates	•		•		•		•	•	•
Chief Risk Officer's report	•		•		•		•	•	•
government relations	•		•		•		•	•	•
PRA relations	•	•			•				
Governance and stakeholders									
governance updates	•		•	•	•		•	•	•
Board evaluation and actions tracking	•						•		•
succession planning	•			•				•	
corporate responsibility reporting and ESG		•							•
diversity and inclusion			•		•				
talent review									•
Non-executive Directors' fees				•					
feedback on investor meetings	•							•	•

Notes

(1) The Board held two meetings in March 2017.

(2) Strategic projects during the year included the merger of our business units M&G and Prudential UK & Europe and the sale of our broker-dealer network in the USA.

(3)

Prior to their merger in August 2017, M&G and Prudential UK & Europe reported to the Board separately.

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Board and Committee meeting attendance throughout 2017

Individual Directors' attendance at meetings throughout the year is set out in the table below.

	Board	Audit Committee	Nomination & Governance Committee	Remuneration Committee	Risk Committee	Joint Audit and Risk Committee	General Meeting
Number of meetings held	10	9	4	6	6	1	1
Chairman							
Paul Manduca	10		4				1
Executive Directors							
Mike Wells	10						1
Mark FitzPatrick(1)	5/5						
John Foley	10						1
Nic Nicandrou	10						1
Anne Richards	10						1
Barry Stowe	10						1
Executive Directors who stepped down during the year							
Tony Wilkey(2)	4/5						1
Penny James(3)	8/8						1
Non-executive Directors							
Philip Remnant	10	9	4	6		1	1
Howard Davies	10	9	4		6	1	1
David Law	10	9	2/2		3/3	1	1
Kai Nargolwala	10			6	6	1	1
Anthony Nightingale	10		4	6			1
Alice Schroeder	10	9				1	1
Lord Turner	10	5/5			6	1	1
Tom Watjen(4)	5/5			2/2			
Non-executive Director who stepped down during the year							
Ann Godbehere(5)	4/4	4/4	2/2		3/3	1	1

Notes

(1) Mark FitzPatrick joined the Board with effect from 17 July 2017.

(2)

Tony Wilkey stepped down from the Board with effect from 17 July 2017.

(3)
Penny James stepped down from the Board with effect from 30 September 2017.

(4)
Tom Watjen joined the Board with effect from 11 July 2017.

(5)
Ann Godbehere retired from the Board with effect from 18 May 2017.

Full details of changes to the Board during the year can be found in the Board of Directors section.

Board and Committee papers are usually provided one week in advance of a meeting. Where a Director is unable to attend a meeting, his or her views are canvassed in advance by the Chairman of that meeting where possible.

Board effectiveness

Actions during 2017

During the year, the action points that had been identified in the 2016 evaluation were addressed and the Board received an update on progress against those actions in September 2017 and February 2018.

Subsidiary governance the 2016 review identified that ensuring good subsidiary governance was maintained was a continuing priority from 2015.

Group Secretariat continued to monitor and support the regular interactions between the Chairman, Audit Committee Chair and Risk Committee Chair with their Material Subsidiary counterparts;

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Reports of all material issues at subsidiary level were given to the Board and to the Audit and Risk Committees as regular agenda items;

Subsidiary independent non-executive directors and chairs, along with all Prudential Non-executive Directors, were invited to a meeting at which the Executive team gave presentations on each business unit with a question and answer session. The sessions also provided the opportunity for the Prudential Board and subsidiary boards to spend time together in an informal setting; and

Group Secretariat continued its established quarterly 'round table' sessions with subsidiary counterparts to share governance best practices.

Board agenda the 2016 review noted that time spent at meetings should flex to reflect strategic priorities, with an increased focus on products and customers.

Agendas continued to be reviewed by the Chairman, Group Chief Executive and the Group General Counsel and Company Secretary, as well as other senior executives where appropriate;

The Board specifically debated at its July 2017 meeting, as part of a wider discussion on good governance, whether sufficient time was allowed for discussion and debate and concluded positively; and

The aspiration to create an information pack on products and markets for Board background information was developed into an app, which was trialled to the GEC in the first quarter of 2018.

Senior employee focus the 2016 review noted the focus on rebuilding strength in senior management teams around the Group, following a number of successful internal promotions.

The Board met all members of the Prudential Corporation Asia executive committee as well as a number of senior Prudential Corporation Asia executives at its Jakarta sessions in April 2017. All members of the Prudential Indonesia executive committee also presented to the Board on this occasion;

The Board held a two-day session in Craigforth in September 2017 at which the M&G Prudential executive committee and senior executives gave business and strategy updates, including on the merger of the M&G and UK & Europe businesses;

The Board received reports from all business units at its meetings on key joiners and leavers; and

A number of senior executives below GEC level presented to each of the Audit Committee and Risk Committee on a regular basis during the year.

Remuneration the 2016 review noted the growing complexity of remuneration across all UK-listed companies and, over the course of 2017, the Board noted the increased governance focus in this area.

A training session on remuneration was established for those Non-executive Directors who do not serve on the Remuneration Committee, to discuss the Directors' Remuneration Policy and broader market practice information. This took place in May 2017 and further sessions will be delivered on an as-required basis; and

A specific and detailed induction was arranged for Mr Watjen on his appointment, given his role as a member of the Remuneration Committee.

2017 review and actions for 2018

The Board undertook an external evaluation of its performance and that of its Committees in 2017. The review was facilitated by Boardroom Review Limited, a consultancy which undertakes no other business for the Company. The external nature of the review met the provision of the UK Corporate Governance Code which requires external evaluations on no less than three-yearly intervals.

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The evaluation included interviews with all Board members and the Group General Counsel and Company Secretary, and attendance and observation by Dr Tracy Long at a number of Board and Committee meetings. Supporting materials to enhance the assessment team's understanding of how the Board and its Committees operate were provided.

The findings were presented to the Board in December 2017 and a collective Board discussion to exchange ideas and agree priorities arising from the report took place.

The report identified a number of strengths of the Board, including strong leadership from the Chairman and Group Chief Executive; a collegiate and constructive environment; effective use of time; high quality information flow; robust risk and control oversight; appropriate tone through the Remuneration Committee; attention to leadership development and effective shareholder communication.

Through the evaluation and subsequent discussion at the Board meeting in February 2018, the Board identified areas of particular focus and related actions:

Theme	Summary of actions
Creating the right environment for critical decision making	Spend additional time on site visits. Continue to hold Non-executive Director only sessions on an as-required basis
Highlighting culture on the agenda	Provide further reports to the Board on culture in 2018 and mature the Group's strategic objective to 'develop a framework for a measurable, definable culture'
Increasing the Board's resilience	Continue to focus on gender and other diversity in all new Board appointments. Introduce a skills map to monitor experience and expertise more formally

Director evaluation

The performance during 2017 of the Non-executive Directors and the Group Chief Executive was evaluated by the Chairman in individual meetings. Philip Remnant, the Senior Independent Director, led the Non-executive Directors in a performance evaluation of the Chairman.

Executive Directors are subject to regular review and the Group Chief Executive individually appraised the performance of each of the Executive Directors as part of the annual Group-wide performance evaluation of all staff.

The outcome of these evaluations is reported to the Nomination & Governance Committee in February each year in order to inform the Committee's recommendation that each Board member be put forward for re-election by shareholders.

Executive Director performance is also reviewed by the Remuneration Committee as part of its deliberations on bonus payments.

Building Directors' knowledge

Induction new Directors

On appointment, each new Director is provided with a comprehensive induction, tailored to reflect the experience of the individual and his or her position as a Non-executive or Executive Director.

Our two new Directors, Mr Watjen and Mr FitzPatrick each received a full induction to the business.

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A summary of the general topics covered, as well as the role specific topics on which they each received comprehensive briefings, are set out in the table below.

General induction programme relevant to all new Directors		Role-specific induction programme for new Directors	
Understanding our governance	**Understanding our business**	**Mark FitzPatrick**	**Tom Watjen**
Meetings with the Chairman and the Group Chief Executive separately	Tailored briefings with each business unit to gain a comprehensive understanding of each of their business models, product suites, pricing arrangements and governance structures	Tailored meetings with members of the Group Finance function	Human Resources-specific induction provided by the Director of Human Resources, including an overview of Group Reward, current UK remuneration hot topics, and the role of the Remuneration Committee and business unit remuneration committees
Explanation of the Group's strategy and business plan	Introductory meetings with all Group functions	Company financial reporting overview on key Group issues including US GAAP differences, IFRS Insurance Performance Management, IFRS contracts and tax	Meeting with the Chair of the Remuneration Committee to discuss the annual cycle of Committee work, its current focus and focus for 2018 and beyond
Explanation of Prudential's corporate structure, Board and Executive Committee structure	Comprehensive briefings on the regulatory environment in which the Group operates	Walkthrough of financial reporting disclosures	
Briefings on Group governance framework and key policies	Briefings on top risks and internal controls	Additional tailored support in his first role as Chief Financial Officer of a global financial services operation	
Training as needed on the rules and governance requirements of the London and Hong Kong Stock Exchanges and on fulfilling the statutory duties of a Director			

Induction role changes

Since Mr Nicandrou was appointed Chief Executive of Prudential Corporation Asia he has continued to deepen his knowledge of the Asia business with a tour of operations across each of the 14 markets in which Prudential Corporation Asia operates. As part of his visits, Mr Nicandrou spent time with senior management, staff and agents of both Prudential Corporation Asia's Life and Eastspring operations. He held a regional conference to provide insights on the strategic direction of the business and to discuss opportunities to broaden distribution, simplify products and services, and the role of digital technology in upgrading the way the business engages and services its customers. He has also engaged extensively with regulators, government officials, existing and prospective partners and hosted a regional investor conference.

Mr Law had been a member of the Audit Committee for almost two years at the time of his appointment as Chair, which provided him with detailed knowledge of its operations and he worked closely with the outgoing Chair to ensure a smooth transition. In addition Mr Law met with

the Chief Financial Officer and other members of Group Finance, the Group-wide Internal Audit Director, the Group Regulatory and Government Relations Director and the Director of Group Compliance in preparation for his role as Chair. Mr Law attended one of each of the Material Subsidiary audit committee meetings to gain a better understanding of their operations. He also met with the Group

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Chief Risk Officer and other members of Group Risk to prepare him for his role as a member of the Risk Committee.

Lord Turner received a detailed briefing from the Director of Group Finance on appointment to the Audit Committee.

A full description of all Board and role changes during 2017 are set out in the Board of Directors section.

Board site visits

Jakarta, Indonesia March 2017

All Board members made a site visit to the Group's operations in Jakarta, Indonesia in March 2017. The visit included presentations from the Prudential Corporation Asia executive team on regional financial performance and an overview of the asset management and life businesses across Asia.

This was followed by detailed presentations by the local Indonesian executive team focusing on agency, Sharia strategy, products, operations, compliance and risk management, brand and corporate social responsibility.

The Board also attended an agency 'Greater Together' recognition event at the Kasablanca Hall with more than 4,000 agents and visited an agency training centre and two agency offices in Menara 88 (PruVictory and PruFavor) which gave an opportunity to see the Group's distribution in action.

Craigforth, Scotland September 2017

All Board and GEC members visited the Group's operations in Craigforth, Scotland in September 2017. The visit included presentations from the M&G Prudential executive team, which gave opportunity to demonstrate to the Board the activity that had taken place in merging the M&G and Prudential life businesses.

In addition, focus sessions were held to provide an in-depth understanding of Prudential Savings & Retirement Solutions and M&G. These included sessions on the annuities business, the customer vision and strategy, distribution, investment management, transformation and culture.

As well as formal presentations, the Board visited different parts of the Craigforth site for demonstrations from employees on typical processing systems and technology innovation.

Continuing development of knowledge and skills

During 2017, the Board and its Committees received a number of technical and business updates as part of their scheduled meetings, providing information on external developments relevant to the Group and on particular products or operations. Below is an overview of how Directors are kept up to date:

- The Board holds an annual strategy session, which allows for detailed updates on each of the business units and deep dives on strategic direction and objectives for the Group;

- The Board receives updates on brand and corporate responsibility activities, usually once a year;

- The Board receives updates at each of its full Board meetings on corporate governance, political and regulatory developments, and the dynamics of equity and currency markets. In 2017, this included updates on the political environment, such as Brexit and tax reform in the USA. The Board also considered MiFID II, the General Data Protection Regulation, the Modern Slavery Act, and the review of the FRC's UK Corporate Governance Code;

In December 2017, the Group ran a focused cyber training session for members of the Risk and Audit Committees, which was open to all Directors;

The Board reviews each business unit at least once a year and conducts periodic site visits as part of this. In 2017, the Board met in Jakarta, Indonesia and Craigforth, Scotland. Details of the activities undertaken on these visits are set out above;

The Board and the Risk Committee receive regular updates on market developments and key risks, including updates on Solvency II and cyber risk. The Risk Committee reviews top risks on an annual basis and deep dives into specific topics in response to the identification of key risks. This review covers the financial, operational and strategic risks, whilst also identifying and addressing business environment and insurance risks within the Group. The identification of such risks inform the risk reporting provided to the Committee and the Board;

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The Audit Committee receives updates on developments affecting financial reporting and the role of audit committees generally. In 2017 this included updates on MiFID II, audit matters for consideration, and financial reporting disclosures as well as forward looking consideration for IFRS 17; and

The Remuneration Committee receives updates on regulatory and governance developments affecting the Group's remuneration arrangements. In 2017, these included the PRA's guidance on Solvency II remuneration requirements, the Investment Association Principles of Remuneration, BEIS Corporate Governance reform concerning remuneration and gender pay gap reporting.

Further information on the activities of the Board and its Committees can be found in the tables explaining how the Board and its Committees spent their time.

All Directors have the opportunity to discuss their individual development needs as part of the annual Board effectiveness review and Directors are asked to provide a record of training received externally on an annual basis. All Directors have the right to obtain professional advice at Prudential's expense.

Diversity

Given the global reach of the Group's operations, and our business strategy and long-term focus, the Board makes every effort to ensure it is able to recruit Directors from different backgrounds, with diverse experience, perspective and skills. This diversity not only contributes towards Board effectiveness but is essential for successfully delivering the strategy of an international Group.

This is reflected in our Group Diversity and Inclusion Policy which aims to provide equal opportunities to all who apply for and who perform work for our organisation including our Directors irrespective of sex, race, age, ethnic origin, educational, social and cultural background, marital status, pregnancy and maternity, civil partnership status, any gender reassignment, religion or belief, sexual orientation, disability, or part-time/fixed-term work, and to ensure appropriate diversity of experience, skill sets and professional backgrounds.

The Board is committed to recruiting the best available talent and appointing the most appropriate candidate for each role while at the same time aiming for an appropriate diversity on the Board. The Nomination & Governance Committee takes into account the Group Diversity and Inclusion Policy when considering succession planning. Prudential has a preference for using suppliers recognised for their commitment to diversity. The Board considers that its diversity of experience, skill-set and professional background has been increased as a result of Board level succession in 2017.

The Board continues to commit to developing a robust and diverse talent pipeline and to increasing representation of women in senior positions in the Group and on the Board. As part of this commitment the Board may endorse relevant measurable objectives for increasing diversity. For example, in 2016 the Board decided to sign the HM Treasury Women in Finance Charter with an aim to achieve at least 30 per cent of women in senior management by the end of 2021 and in 2017, all Executive Directors volunteered to mentor members from our senior management team of various ages, gender, educational and professional backgrounds. The Group also engaged in a number of targeted activities in support of our Diversity and Inclusion Policy, including awareness training of unconscious bias.

Shareholder engagement

As a major institutional investor, the Board recognises the importance of maintaining an appropriate level of two-way communication with shareholders.

A full programme of engagement with shareholders, potential investors and analysts, in the UK and overseas, is conducted each year by the Group Chief Executive and the Chief Financial Officer, led by the Investor Relations team. A conference for investors and analysts is held on a regular basis, including

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in-depth business presentations and opportunities for attendees to meet with members of the Board and senior executives and an opportunity for the executive team to communicate progress and strategy outside of the financial reporting cycle. The most recent event was held in November 2017 and feedback was provided to the Board in December 2017.

The Group Chief Executive, Chief Financial Officer and Investor Relations team also attend major financial services conferences to present to and meet with the Company's shareholders.

In 2017, as part of the investor relations programme, over 320 meetings were held with approximately 700 individual institutional investors in London, continental Europe, the USA and Asia.

The Company holds an ongoing programme of regular contact with major shareholders, conducted by the Chairman, to discuss their views on the Company's governance. The Senior Independent Director offers meetings to major shareholders as needed. Engagement with institutional investors on the Directors' Remuneration Policy and implementation is led by the Remuneration Committee Chair. Other Non-executive Directors are available to meet with major shareholders on request.

Shareholder feedback and key issues from these meetings is communicated to the Board. Details of when feedback was discussed by the Board in 2017 can be found in the table 'Key areas of focus how the Board spent its time'.

The Annual General Meeting is an opportunity for further shareholder engagement, for the Chairman to explain the Company's progress and, along with other members of the Board, to answer any questions. All Directors then in office attended the 2017 Annual General Meeting.

Further information on Directors

Information on a number of regulations and processes relevant to Directors, and how these are addressed by Prudential, is given below.

Area	**Prudential's approach**
Rules governing appointment and removal	The appointment and removal of Directors is governed by the provisions in the Articles of Association (the Articles), the UK Corporate Governance Code (the UK Code), the Hong Kong Corporate Governance Code (HK Code) as appended to the Hong Kong Listing Rules (the HK Listing Rules) and the Companies Act 2006.
Terms of appointment	Non-executive Director tenure is shown in 'Compensation'.
	Non-executive Directors are appointed for an initial term of three years, commencing with their election by shareholders.
	Subject to review by the Nomination & Governance Committee and re-election by shareholders, it would be expected that Non-executive Directors serve a second term of three years.
	After six years, Non-executive Directors may be appointed for a further year, up to a maximum of three years in total. Reappointment is subject to rigorous review as well as re-election by shareholders.
	The Directors' remuneration report sets out the terms of the Non-executive Directors' letters of appointment and the terms of Executive Directors' service contracts.

Time commitment

At present, the average time commitment expected of a Non-executive Director is 32.5 days per annum. In addition, all Non-executive Directors currently serve on at least one of the Board's principal Committees, which requires an additional commitment of time dependent on the Committee and role.

On appointment, all Non-executive Directors confirm they are able to devote sufficient time to the Group's affairs to meet the demands of the role.

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Area	Prudential's approach
	All Non-executive Directors are required to discuss any additional commitments which might impact the time which he or she is able to devote to their role with the Chairman prior to accepting.
Independence	The independence of the Non-executive Directors is determined by reference to the UK Code and HK Listing Rules as follows: for the purposes of the UK Code, throughout the year, all Non-executive Directors were considered by the Board to be independent in character and judgement and to have met the criteria for independence as set out in the UK Code; and all the Non-executive Directors were considered independent for the purposes of the HK Listing Rules, and each Non-executive Director provides an annual confirmation of his or her independence as required under the HK Listing Rules. In accordance with US regulatory requirements, Prudential affirms annually that all members of the Audit Committee are independent within the meaning of the Sarbanes-Oxley legislation. Prudential is one of the UK's largest institutional investors. The Board does not believe that this compromises the independence of those Non-executive Directors who are on the boards of companies in which the Group has a shareholding. The Board also believes that such shareholdings should not preclude the Company from having the most appropriate and highest calibre Non-executive Directors.
Audit Committee experience	In relation to the provisions of the UK Corporate Governance Code and HK Listing Rules, the Board is satisfied that Mr Law has recent and relevant financial experience and that the Committee as a whole has competence relevant to the sectors in which the business operates. Full biographies of the Committee members including experience and professional qualifications, are set out in the Board of Directors section.
Indemnities	Subject to the provisions of the Companies Act 2006, the Company's Articles permit the Directors and officers of the Company to be indemnified in respect of liabilities incurred as a result of their office. Suitable insurance cover is in place in respect of legal action against directors and senior managers of companies within the Group. Qualifying third-party indemnity provisions are also available for the benefit of the Directors of the Company and certain other such persons, including certain directors of other companies within the Group.

Qualifying pension scheme indemnity provisions are also in place for the benefit of certain pension trustee directors within the Group.

These indemnities were in force during 2017 and remain so.

Significant contracts

At no time during the year did any Director hold a material interest in any contract of significance with the Company or any subsidiary undertaking.

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Governance Committees

Committee Reports

The principal Board Committees are the Nomination & Governance, Audit, Risk and Remuneration Committees. These Committees form a key element to the Group governance framework, facilitating effective independent oversight of the Group's activities by the Non-executive Directors.

Each Committee Chair provides an update to the Board of each Committee meeting, supported by a short written summary of the Committee business considered.

Nomination & Governance Committee report

This report describes how the Nomination & Governance Committee has fulfilled its duties under its terms of reference during the year.

The Board changes in 2017 have again demonstrated the effectiveness of its preparations for Board level succession. Full details of all Board changes during the year can be found in the Board of Directors section.

The smooth transition of David Law as the new Audit Committee Chair, who also joined this Committee in May, and the appointment and induction of Tom Watjen has helped to refresh the Non-executive roles on the Board.

The move by Nic Nicandrou to become Chief Executive of Prudential Corporation Asia and the appointment of Mark FitzPatrick as Chief Financial Officer demonstrates both the effectiveness of the succession planning preparations and the ability of the Committee to recruit high calibre candidates with the appropriate skills and knowledge for the business.

Having the right individuals in place in leadership roles is fundamental to the successful delivery of Prudential's strategy. The Board requires a diverse skill set which can be deployed across the Committees and businesses for the benefit of the Group and its stakeholders.

Careful ongoing review and planning ensures that the Board continues to attract the high calibre individuals it requires and that there are no gaps in leadership. In 2017, the Committee formalised its approach in this area by creating a skills map to support succession planning, which identifies sector-specific and general operational competencies as well as geographic and business experience.

The retirement of Ann Godbehere, in May 2017, at the end of nine years of service as a Non-executive Director, and Penny James stepping down as an Executive Director and Group Chief Risk Officer in September 2017, have impacted the Board's gender diversity. The Committee has therefore committed to focus particularly on strengthening gender diversity, alongside diversity of skills, in its succession planning in 2018.

The role of the Committee has grown since 2016 when it took on responsibility for overseeing the governance arrangements in the Group. This includes the governance of its Material Subsidiaries, in order to ensure that those boards operate effectively and that the independent non-executive directors can constructively challenge and monitor performance in those businesses. The Committee spent time considering the composition and effectiveness of those boards, the processes around its risk and audit committees, and the tenure and succession of its non-executives.

The Committee Chair oversees the governance arrangements for the Committee. The Committee considered its terms of reference in November 2017, and in the preparation of this report the Chairman considered the time commitment, number of meetings and skills and experiences required for Committee members.

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The Committee Chair also has responsibility for ensuring the Committee runs effectively and makes the most of its meeting time. To ensure it does so, open debate and contributions from all Committee members is encouraged by the Committee Chair.

As part of the Board's effectiveness review, described in more detail in the How We Operate section, the Committee was found to be operating effectively and given action points around developing its skills map and considering Committee membership, both of which are ongoing tasks.

Committee members

Paul Manduca (Chair)
Howard Davies
David Law (from May 2017)
Anthony Nightingale
Philip Remnant
Ann Godbehere (until May 2017)

Regular attendees

Group Chief Executive
Group Human Resources Director
Group General Counsel and Company Secretary

Number of meetings in 2017: Four

How the Committee spent its time during 2017

	Feb	May	Jun	Nov
Year end matters, re-election and tenure				
review external positions, conflicts of interests and independence, time commitment, tenure and terms of appointment	•			
review performance of Chairman and Non-executive Directors	•			
review relevant disclosures in the Annual Report and Accounts	•			
recommend election of Directors by shareholders	•			
Succession planning, skills mapping and appointments				
Chairman				•
Non-executive Directors	•		•	•
Group Chief Executive	•			
Executive Directors		•		•
GEC composition				•
Governance				
membership review of principal Board Committees	•			
Committee terms of reference				•
Material Subsidiary governance				
subsidiary board composition, non-executive succession planning and appointments			•	•
Material Subsidiary committee attendance				•
terms of reference for Material Subsidiary boards, chairs and committees	•			•
Material Subsidiary governance manual	•			•
Material Subsidiary board, chair and director evaluations	•			

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Key matters considered during the year

Matter considered	How the Committee addressed the matter
Succession planning	
Succession planning	Throughout the year, the Committee kept succession plans for all Executive and Non-executive Board roles under review. Succession plans are supported by the year end Board evaluation and individual performance evaluations. The Committee takes account of the size, structure and composition of the Board and its Committees, including existing knowledge, experience and diversity. In doing so, the Committee considers the Group's strategic needs and anticipates future needs, skills and experience. The Committee is responsible for developing and periodically reviewing objectives established for the implementation of diversity on the Board and monitoring progress toward the achievements of those objectives. A description of the Group Diversity and Inclusion Policy is included in the How We Operate Section. Following the departure of Ann Godbehere and Penny James in 2017, the Committee is focusing on gender diversity, alongside diversity of skills, in its succession planning in 2018. The Committee works with the Group Chief Executive and Group Human Resources Director to ensure that when a vacancy or a gap in the Board's skills is identified, a role specification is prepared, taking into account feedback from the Committee and the Group's Diversity and Inclusion Policy. Once the specification is agreed, specialist talent agencies are typically engaged to create a shortlist of candidates for review by the Committee and other stakeholders. Interviews with individuals then take place and feedback is provided to the Committee members. In this manner, a preferred candidate is selected and the Committee then recommends the individual to the Board for appointment (subject to regulatory approval where required). Contemporaneously with this process, thorough due diligence checks are undertaken on the candidate and we liaise with the FCA and PRA as to the suitability of the individual from a regulatory perspective, as needed.
Non-executive Directors	During the year, the Committee finalised the terms of appointment of Mr Watjen as a Non-executive Director. The work of the Committee was supported by Russell Reynolds as search consultant. In 2017, the Committee debated and approved a skills map for use in Non-executive succession planning discussions. The skills map identifies key skills and experiences, including sector, geographic and operational skills, which are desirable for the Board as a whole, taking account of the Group's strategic direction. As part of its focus on searching for an additional Non-executive Director, in November 2017 The Miles Partnership was instructed to begin a market mapping exercise with particular focus on potential female candidates to ensure that the Board's gender diversity was addressed in a positive manner.

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Executive Directors and senior executives	The Committee carried out its annual review of the succession plans in place for the Group Chief Executive, other Executive Directors and Group Executive Committee roles. The development and renewal of these plans was led by the Group HR Director, supported by Egon Zehnder in the case of the Group Chief Executive plan and by Talent Intelligence for the other Executive Director roles and GEC members. In 2017, Talent Intelligence prepared long-lists and short-lists with a focus on gender and ethnic diversity requirements. The Committee has oversight of senior executive level succession planning and the talent pipeline. The Committee discussed these plans closely with the Group Chief Executive to identify business requirements and plan for future succession needs and gave feedback on the planning process. The Company continues to commit to developing a robust and diverse talent pipeline, increasing representation of women in senior positions. During 2017: Mr FitzPatrick was appointed as Chief Financial Officer in July 2017, following completion of a comprehensive search; Following the departure of Penny James in September 2017, Prudential appointed Pat Casey as Interim Group Chief Risk Officer while the search for a permanent successor continued. Following a recommendation from the Committee, the Board appointed James Turner as an Executive Director and as Group Chief Risk Officer with effect from 1 March 2018; and Mr Nicandrou took on the role of Chief Executive Prudential Corporation Asia, following Mr Wilkey's departure. In each case, the Committee was well prepared and responsive, considering candidate profiles and skills and conducting interviews.

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Use of search consultancies	Neither Russell Reynolds nor The Miles Partnership have any additional connection with Prudential. In addition to acting as search consultant for certain executive hires, Egon Zehnder also provides support for senior development assessments. Talent Intelligence also provides additional succession planning support to the Group below GEC level.
Review of principal Committee membership	The Committee regularly reviews the membership of all principal Committees and makes recommendations to the Board as appropriate. In February 2017, the Committee made recommendations to the Board to appoint Lord Turner to the Audit Committee and to appoint Mr Law to the Risk Committee and as Audit Committee Chair, which changes became effective in May 2017. The Committee recommended the appointment of Mr Watjen to the Remuneration Committee on his appointment as a Non-executive Director in July 2017. In February 2018, the Committee also recommended the appointment of Ms Schroeder as a member of the Risk Committee, which was effective from 1 March 2018. Full details of changes to the membership of the principal Committees are set out in the Board of Directors section.
Election of Directors	As part of its ongoing work on Board succession planning, the Committee considered the terms of appointment for the Chairman, Committee Chairs and Non-executive Directors taking into account time commitment and the general balance of skills, diversity, experience and knowledge on the Board, assessing length of service in their roles. Particular attention has been paid to the recommendation to re-elect Mr Nargolwala and Sir Howard Davies at the Annual General Meeting to be held in 2018 due to their length of service. Having reviewed the performance of the Non-executive Directors in office at the time, and having received feedback from the Group Chief Executive on the performance of the Executive Directors, the Committee concluded that each Director continued to perform effectively and was able to devote sufficient time to fulfil their duties, taking account of the number and nature of their external appointments. The Committee recommended to the Board that all Directors should stand for election at the Company's Annual General Meeting.

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Independence and conflicts of interest

Independence criteria	The Committee considered the independence of the Non-executive Directors against relevant requirements as outlined in the Further Information on Directors section.
Conflicts of interest	The Board has delegated authority to the Committee to consider, and authorise where necessary, any actual or potential conflicts of interest. Prior to proposing Directors for re-election, the Committee considered the external appointments of all Directors and reviewed existing conflict authorisations, reaffirming or updating any terms or conditions attached to authorisations where required. In addition, the Committee considered the external positions of those Directors appointed during the year, noted changes in the external positions of existing Directors and considered whether these gave rise to any conflicts. The Board considers that the procedures set out above for dealing with conflicts of interest, operate effectively.

Governance

Group subsidiaries	During the year under review, the Committee carried out various duties related to the Material Subsidiaries including succession

planning arrangements for non-executive directors, evaluating the performance of the Material Subsidiary boards, chairs and directors, reviewing Material Subsidiary governance arrangements, including principles for attendance at committee meetings, and the terms of reference for the Material Subsidiary boards and chairs.

Appointment of Tom Watjen

The Committee undertook a thorough and international search for potential candidates, supported by Russell Reynolds who were engaged for this purpose. The objective of the search was to enhance the Board's US expertise and insurance executive experience. Mr Watjen was identified as a preferred candidate following interviews with the Chairman, the Senior Independent Director and Group Chief Executive. The Committee reviewed Mr Watjen's skills and experiences against the needs of the business, noting in particular his knowledge of the insurance sector, his many years in senior executive roles and his understanding of US regulatory matters. His appointment was then recommended to the Board for consideration and subsequently approved in July 2017.

Audit Committee report

This report describes how the Audit Committee has fulfilled its duties under its terms of reference during the year.

Following the retirement of Ann Godbehere from the Board in May 2017, David Law has taken over responsibility as Chair of the Committee, building upon the significant contribution Ann made to the Committee during her nine years of service.

In May 2017 Lord Turner joined as an additional Committee member. Lord Turner's biography is included in the Board of Directors section.

A key part of the Committee's role is to provide the Board with assurance as to the integrity of the business through its activities in monitoring financial reporting and the second and third lines of defence as part of the internal control environment.

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The Committee continued to focus on the integrity of the Group's financial reporting and ensuring appropriate financial accounting policies are adopted and implemented. It also reviewed management's annual process for setting assumptions which underpin the Group's IFRS insurance liabilities and European Embedded Value (EEV) results and requested additional information and clarification where needed. Building on work undertaken in prior years, in 2017 the Committee further accelerated its year end process and carried out a substantive review of key judgements, such as UK mortality and expenses, policyholder behaviour assumptions in Jackson and, for EEV reporting in particular, persistency in Asia, before the year end. As in previous years, the Committee reviewed the Group's Annual Report and Accounts and advised the Board that they were considered to be fair, balanced and understandable. The Committee also reviewed the Group's Solvency II reporting disclosures forming part of its 2016 full year and 2017 half and full year reports. Following a transfer of duties from the Risk Committee during the year, the Committee is now responsible for reviewing the Solvency and Financial Condition Report (SFCR) and the Regulatory Supervisory Report (RSR), which is a private regulatory filing.

An important part of the Committee's duties is to monitor the relationship with the Group's external and internal auditors. The Committee reviewed the activities of KPMG as external auditor and made a recommendation to the Board concerning their continuing appointment (subject to shareholder approval) which took into account a number of factors including independence and objectivity, the level of remuneration, effectiveness, and tenure. The Committee also approved non audit work that was considered appropriate and in line with the Group's policy. During the year, KPMG scored highly in the Committee's effectiveness review which included feedback from senior finance personnel across all the Group's business units. It remains the Committee's current view that, without exceptional circumstances, change to auditors should not occur prior to the adoption of the new accounting standards on insurance contracts (IFRS 17). A plan to identify their successors to ensure a smooth transition has been developed.

During the year the Committee continued to receive regular briefings from the Group-wide Internal Audit (GwIA) function. Delivery of the internal audit plan represents a key component of the Committee's oversight of the Group's internal controls procedures. GwIA undertook a programme of risk-based audits covering matters across the business units in addition to assurance work on significant change programmes such as preparations for the implementation of the General Data Protection Regulations (GDPR) and MiFID II. The Committee also approved the 2018 audit plan which focuses on matters such as financial, business change, regulatory and operational risks as well as consideration of controls to deliver appropriate customer outcomes. The plan was mapped to the key risks identified by the Group Risk Committee and is kept under review throughout the year as necessary to ensure the programme remains in line with business needs.

The Committee regularly reviews the performance of GwIA and monitors the adequacy of the resourcing available to the function. In addition, in 2017 an independent External Quality Assessment (EQA) of GwIA was undertaken by Deloitte in line with the Chartered Institute of Internal Auditors Standards (the Standards). The EQA concluded that GwIA met the Standards and code of ethics, and assisted both the Committee and the executive management in identifying and mitigating risk.

During the year the Committee Chair was involved in recruiting a successor to the role of Director of GwIA. After an extensive internal and external search, the Committee appointed an individual with extensive knowledge of the Group, having previously been the Chief Operating Officer of Group Risk, and before that the Group Compliance Director.

The Committee received updates against the annual Compliance Plan (the Plan). In 2017 the Plan focused on a number of areas to help strengthen the compliance framework, which is intended to aid the Group in meeting regulatory obligations. The Plan also included the management and review of Group Compliance top risks, including anti-money laundering and anti-bribery and corruption.

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The Committee also refreshed the Group's whistleblowing protocols and spent time with the Group Resilience Director to gain comfort that he was appropriately supported. The Committee sponsored a special review to ensure there was no evidence of abuse of power in the workplace.

During 2017 the Committee reviewed the Group's first published tax strategy and environmental, social and governance (ESG) report, both released in May. Another key piece of work was the review of the disclosures about the merger of M&G and Prudential UK & Europe into one business and an additional meeting was held to discuss these. Members of the Committee also received additional updates on the impact of MiFID II and reviewed the financial disclosures relating to the partial sale of the UK annuity portfolio.

The Committee looks to identify matters likely to impact the Group going forward. In addition to its usual activities, in 2018 the Committee expects to consider further the impact of IFRS 17, as well as monitoring regulatory changes and the impact of major projects such as the creation of M&G Prudential on the Group's internal controls functions.

The Committee also works closely with the Risk Committee to make sure both Committees are updated and aligned on matters of common interest. Where responsibilities are perceived to overlap between the two Committees, the Committee Chair works with Sir Howard to agree the most appropriate Committee to consider the matter. In December both Committees held a joint informational session on cyber security, to which all Directors were invited.

As part of the transition for the Committee Chair, as well as the regular meetings with the Material Subsidiary audit committee chairs to facilitate escalation of important matters and reporting of material issues to the Committee, the Chair attended one of each of the Material Subsidiary audit committee meetings to gain a better understanding of how they operate. This was found to be helpful and the Committee will look to repeat this in the coming years.

It is the role of the Chair to consider the governance arrangements for the Committee. The Committee considers its terms of reference at least annually and proposed changes to its terms of reference in December 2017. The only significant change related to the review of Solvency II disclosures which now rests with the Committee.

The Committee Chair also has the responsibility for ensuring the Committee runs effectively. To ensure it does so and provides constructive challenge to management, open debate and contributions from all Committee members is encouraged by the Chair.

Committee members are encouraged to meet with management or the internal and external audit team where this assists them in their preparations. The Committee Chair reports to the full Board after each meeting on the main matters discussed.

An annual review of the Committee's effectiveness was carried out as part of the Board evaluation, described in more detail in the How We Operate section. The Committee was found to be functioning effectively.

Committee members

David Law (Chair) (from May 2017)
Ann Godbehere (until May 2017)
Howard Davies
Philip Remnant
Alice Schroeder
Lord Turner (from May 2017)

Regular attendees

Chairman of the Board
Group Chief Executive
Chief Financial Officer
Group Chief Risk Officer
Director of Group Finance
Group Regulatory and Government Relations Director
Group General Counsel and Company Secretary
Director of Group Compliance
Director of Group-wide Internal Audit
External Audit Partner

Number of meetings in 2017: Nine. In addition, a joint meeting was held with the Risk Committee.

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How the Committee spent its time during 2017

	Feb	Mar(1)	May	Jul	Aug(1)	Nov	Dec
Financial reporting and external auditor							
Periodic financial reporting including:							
Key accounting judgements and disclosures	•	•	•	•	•	•	•
Solvency II results and governance processes							
Associated audit reports							
Review of announcement of the merger of M&G and Prudential UK & Europe					•		
Developments in tax disclosures	•		•			•	•
Audit planning, fees, independence, effectiveness and re appointment	•		•	•			
Internal control framework							
Internal control framework effectiveness	•						
Internal auditors							
Status updates and effectiveness	•		•	•		•	•
Internal audit plan				•			•
Compliance							
Status updates	•		•	•		•	•
Compliance plan							•
MiFID II updates						•	•
Financial crime and whistleblowing							
Update on whistleblowing issues raised	•		•	•		•	•
Financial crime prevention including anti-money laundering, prevention of tax evasion and anti-bribery and corruption programmes	•						•
Governance and reporting							
Material Subsidiaries updates	•	•	•	•	•	•	•
Internal framework effectiveness/refresh	•		•	•		•	•
Environmental, social and governance reporting			•				
Business unit audit committee effectiveness, status updates and terms of reference	•		•	•		•	•
Committee terms of reference							•

Note

(1) Two meetings were held in each of March and August 2017.

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Key matters considered during the year

Matter considered	**How the Committee addressed the matter**
Financial reporting and tax	
Overview	One of the Committee's key responsibilities is to monitor the integrity of the financial statements. The Committee assessed whether appropriate accounting policies had been adopted throughout the accounting period and whether management had made appropriate estimates and judgements over the recognition, measurement and presentation of the financial results. There were no new or altered accounting standards in 2017 that had a material effect on the Group's financial statements. The Committee considered compliance with accounting standards and obligations under applicable laws, regulations and governance codes. Particular areas on which the Committee focused during the year included the fair, balanced and understandable requirement under the UK Corporate Governance Code, providing advice to the Board in respect of this requirement and reviewing the up-date of these disclosures for revised reporting requirements. In May 2017 the Group published externally, for the first time, a Group tax strategy document and a Group environmental, social and governance report. Both documents were reviewed by the Committee, which was updated on the approach and progress as the documents were developed.
Key assumptions and judgements	The Committee reviewed the key assumptions and judgements made in valuing the Group's investments, insurance liabilities and deferred acquisition costs under IFRS, together with reports on the operation of internal controls to derive these amounts. It also reviewed the assumptions underpinning the Group's European Embedded Value (EEV) metrics. The Committee considered information, including peer comparisons if relevant and available, on the following key assumptions: Persistency, mortality, morbidity and expense assumptions within the Asia life businesses; Economic and policyholder behaviour assumptions (including mortality) affecting the measurement of Jackson guaranteed liabilities and amortisation of deferred acquisition costs; and Mortality, expense and credit risk assumptions for the UK annuity business. Mortality assumptions were a particular focus for the Committee following a detailed review of granular historic experience data by the UK business and the release of new industry mortality improvement tables. Further information is contained in the consolidated financial statements. The Committee was satisfied that the assumptions adopted by management were appropriate.

Key matters considered during the year

Matter considered	How the Committee addressed the matter
	The Committee also received information on the nature of goodwill and intangible asset values and considered what factors might give rise to an impairment of the Group's intangibles and whether those factors had arisen in the period. The Committee was satisfied that there was no impairment of the Group's intangibles at 31 December 2017. The Committee reviewed and challenged updates to the Group's independent price valuation policy for investments and endorsed the proposed enhancements to Group Finance oversight of this policy. It also received information on the carrying value of investments in the Group's balance sheet including data on the approach used in that valuation (for example, the level of asset valued on a mark to market basis). The Committee satisfied itself that overall investments were valued appropriately. The Committee regularly reviews the Group's provisions, including the level of provisioning for regulatory and litigation matters and provisions for certain open tax items including tax matters in litigation. The Committee was satisfied that the level of provisioning adopted by management was appropriate.
Other financial reporting matters and tax reporting	The Committee considered various analyses from management regarding Group and subsidiary capital and liquidity prior to recommending to the Board that it could conclude that the financial statements should continue to be prepared on the going-concern basis and the disclosures on the Group's longer-term viability were both reasonable and appropriate. As part of its assessment of the description of performance within the Annual Report, the Committee considered judgemental aspects of the Group's reporting across the Group's IFRS and EEV metrics. This assessment included a review to ensure that the allocation of items between operating and non-operating profit was in accordance with the Group's accounting policy. The Committee considered the impact of equity and interest rate movements on the IFRS results of the Group's US business and after discussion, the Committee was satisfied that the presentation and d