

PRUDENTIAL PLC
Form 6-K
August 05, 2011

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the month of August, 2011

PRUDENTIAL PUBLIC LIMITED COMPANY

(Translation of registrant's name into English)

LAURENCE POUNTNEY HILL,
LONDON, EC4R 0HH, ENGLAND
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports
under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark whether the registrant by furnishing the information
contained in this Form is also thereby furnishing the information to the
Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

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

Enclosures: Half Yearly Report 2011 - Part 2 - EEV

European Embedded Value (EEV) basis results

Operating profit based on longer-term investment returnsⁱ

Results analysis by business area

	Note	Half year 2011 £m	Half year 2010 ^{vi} £m	Full year 2010 ^{vi} £m
Asian operations				
New business:				
Excluding Japan	2	465	396	902
Japan ^v		-	(1)	(1)
Total		465	395	901
Business in force	3	309	241	549
Long-term business		774	636	1,450
Asset management		43	36	72
Development expenses		(2)	(3)	(4)
Total		815	669	1,518
US operations				
New business	2	458	361	761
Business in force	3	373	306	697
Long-term business		831	667	1,458
Broker-dealer and asset management		17	15	22
Total		848	682	1,480
UK operations				
New business	2	146	135	365
Business in force	3	391	314	571
Long-term business		537	449	936
General insurance commission		21	23	46
Total UK insurance operations		558	472	982
M&G		199	143	284
Total		757	615	1,266
Other income and expenditure				
Investment return and other income		5	5	30
Interest payable on core structural borrowings		(140)	(129)	(257)
Corporate expenditure		(116)	(113)	(220)
Charge for share-based payments for Prudential schemes		(2)	(3)	(3)
Charge for expected asset management margin ⁱⁱ		(28)	(22)	(44)
Total		(281)	(262)	(494)
RPI to CPI inflation measure change on defined benefit pension schemes ⁱⁱⁱ		45	-	-
Solvency II implementation costs ^{iv}		(28)	(22)	(46)
Restructuring costs ^v		(9)	(5)	(28)
Operating profit based on longer-term investment returns ⁱ		2,147	1,677	3,696
Analysed as profits (losses) from:				
New business:				
Excluding Japan	2	1,069	892	2,028
Japan ^v		-	(1)	(1)
Total		1,069	891	2,027

Edgar Filing: PRUDENTIAL PLC - Form 6-K

Business in force	3	1,073	861	1,817
Long-term business		2,142	1,752	3,844
Asset management		259	194	378
Other results		(254)	(269)	(526)
Total		2,147	1,677	3,696

Notes

i EEV basis operating profit based on longer-term investment returns excludes the recurrent items of short-term fluctuations in investment returns, the mark to market value movements on core borrowings, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, and the effect of changes in economic assumptions. In addition, for half year and full year 2010, operating profit excludes costs associated with the terminated AIA transaction and for full year 2010, the gain arising upon the dilution of the Group's holding in PruHealth. The amounts for these items are included in total EEV profit attributable to shareholders. The Company believes that operating profit, as adjusted for these items, better reflects underlying performance. Profit before tax and basic earnings per share include these items together with actual investment returns. This basis of presentation has been adopted consistently throughout these results.

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

iii During the first half of 2011 the Group altered its inflation measure basis for future statutory increases to pension payments for certain tranches of its UK defined benefit pension schemes. This reflects the UK Government's decision to replace the basis of indexation from RPI with CPI. This resulted in a credit to operating profit for half year 2011 on an IFRS basis of £42 million and an additional £3 million recognised on the EEV basis.

iv Restructuring costs comprise the charge of £(8) million recognised on an IFRS basis and an additional £(1) million recognised on the EEV basis for the shareholders' share of restructuring costs incurred by the PAC with-profits fund. Solvency II implementation costs comprise the charge of £(27) million recognised on an IFRS basis and an additional £(1) million recognised on the EEV basis.

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

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

Summarised consolidated income statement

	Note	Half year 2011 £m	Half year 2010 £m	Full year 2010 £m
Operating profit based on longer-term investment returns				
Asian operations		815	669	1,518
US operations		848	682	1,480
UK operations:				
UK insurance operations		558	472	982
M&G		199	143	284
		757	615	1,266
Other income and expenditure		(281)	(262)	(494)

Edgar Filing: PRUDENTIAL PLC - Form 6-K

RPI to CPI inflation measure change on defined benefit pension schemes		45	-	-
Solvency II implementation costs		(28)	(22)	(46)
Restructuring costs		(9)	(5)	(28)
Operating profit based on longer-term investment returns		2,147	1,677	3,696
Short-term fluctuations in investment returns	5	(111)	(227)	(30)
Mark to market value movements on core borrowings	9	(74)	(42)	(164)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes		(8)	(25)	(11)
Effect of changes in economic assumptions	6	(111)	(52)	(10)
Costs of terminated AIA transaction	4	-	(377)	(377)
Gain on dilution of holding in PruHealth	13	-	-	3
Profit before tax (including actual investment returns)		1,843	954	3,107
Tax attributable to shareholders' profit	11	(572)	(140)	(530)
Profit for the period*		1,271	814	2,577
Attributable to:				
Equity holders of the Company		1,269	812	2,573
Non-controlling interests		2	2	4
Profit for the period		1,271	814	2,577

Earnings per share (in pence)

	Note	Half year 2011	Half year 2010	Full year 2010
From operating profit based on longer-term investment returns, after related tax				
and non-controlling interests of £1,559 million (half year 2010: £1,210 million; full year 2010: £2,700 million**)	12	61.5p	48.0p	106.9p
Based on profit after tax and non-controlling interests* of £1,269 million (half year 2010: £812 million; full year 2010: £2,573 million)	12	50.1p	32.2p	101.9p

* All profit is from continuing operations

** Operating earnings per share for full year 2010 has been determined after excluding an exceptional tax credit of £158 million which primarily related to the impact of a settlement agreed with the UK tax authorities - see note 11

Dividends per share (in pence)

	Half year 2011	Half year 2010	Full year 2010
Dividends relating to reporting period:			
Interim dividend (2011 and 2010)	7.95p	6.61p	6.61p
Final dividend (2010)	-	-	17.24p
Total	7.95p	6.61p	23.85p
Dividends declared and paid in reporting period:			
Current year interim dividend	-	-	6.61p
Final/second interim for prior year	17.24p	13.56p	13.56p
Total	17.24p	13.56p	20.17p

Edgar Filing: PRUDENTIAL PLC - Form 6-K

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

	Note	Half year 2011 £m	Half year 2010 £m	Full year 2010 £m
Profit for the period attributable to equity shareholders		1,269	812	2,573
Items taken directly to equity:				
Exchange movements on foreign operations and net investment hedges:				
Exchange movements arising during the period		(96)	806	659
Related tax		(5)	(8)	34
Dividends		(439)	(344)	(511)
New share capital subscribed (including shares issued in lieu of cash dividends)		15	39	75
Reserve movements in respect of share-based payments		25	15	37
Treasury shares:				
Movement in own shares in respect of share-based payment plans		(10)	8	(4)
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		2	4	3
Mark to market value movements on Jackson assets backing surplus and required capital (gross movement)		39	103	105
Related tax		(14)	(36)	(37)
Net increase in shareholders' equity	10	786	1,399	2,934
Shareholders' equity at beginning of period (excluding non-controlling interests)	7,10	18,207	15,273	15,273
Shareholders' equity at end of period (excluding non-controlling interests)	7,10	18,993	16,672	18,207

	30 Jun 2011 £m			30 Jun 2010 £m			31 Dec 2010 £m			
	Asset			Asset			Asset			
Comprising:	Long-term business operations	management and other operations	Total	Long-term business operations	management and other operations	Total	Long-term business operations	management and other operations	Total	
Asian operations:										
Net assets of operation	7,825	212	8,037	6,736	180	6,916	7,445	197	7,642	
Acquired goodwill	239	61	300	235	61	296	236	61	297	
	7	8,064	273	8,337	6,971	241	7,212	7,681	258	7,939
US operations:										
Net assets of operation	4,821	108	4,929	4,984	111	5,095	4,799	106	4,905	
Acquired goodwill	-	16	16	-	16	16	-	16	16	
	7	4,821	124	4,945	4,984	127	5,111	4,799	122	4,921
UK insurance operations:										
Net assets of operation	6,200	48	6,248	5,442	17	5,459	5,970	33	6,003	
M&G:	-	310	310	-	190	190	-	254	254	

Edgar Filing: PRUDENTIAL PLC - Form 6-K

Net assets of operation										
Acquired goodwill	-	1,153	1,153	-	1,153	1,153	-	1,153	1,153	
	-	1,463	1,463	-	1,343	1,343	-	1,407	1,407	
	7	6,200	1,511	7,711	5,442	1,360	6,802	5,970	1,440	7,410
Other operations:										
Holding company net borrowings at market value	9	-	(2,364)	(2,364)	-	(2,343)	(2,343)	-	(2,212)	(2,212)
Other net assets (liabilities)		-	364	364	-	(110)	(110)	-	149	149
	7	-	(2,000)	(2,000)	-	(2,453)	(2,453)	-	(2,063)	(2,063)
Shareholders' equity at end of period (excluding non-controlling interests)	7	19,085	(92)	18,993	17,397	(725)	16,672	18,450	(243)	18,207
Representing:										
Net assets		18,846	(1,322)	17,524	17,162	(1,955)	15,207	18,214	(1,473)	16,741
Acquired goodwill		239	1,230	1,469	235	1,230	1,465	236	1,230	1,466
		19,085	(92)	18,993	17,397	(725)	16,672	18,450	(243)	18,207

Net asset value per share (in pence)		30 Jun 2011	30 Jun 2010	31 Dec 2010
Based on EEV basis shareholders' equity of £18,993 million (half year 2010: £16,672million; full year 2010: £18,207 million)		745 p	657 p	715 p
Number of issued shares at period end (millions)		2,548	2,539	2,546
Annualised return on embedded value*		17%	16%	18%

* Annualised return an embedded value is based on EEV operating profit after related tax and non-controlling interests as a percentage of opening EEV basis shareholders' equity. Half year profits are annualised by multiplying by two.

Summary statement of financial position

	Note	30 Jun 2011	30 Jun 2010	31 Dec 2010
		£m	£m	£m
Total assets less liabilities, before deduction for insurance funds		239,471	214,771	231,667
Less insurance funds:*				
Policyholder liabilities (net of reinsurers' share) and unallocated				

Edgar Filing: PRUDENTIAL PLC - Form 6-K

	surplus of with-profits funds	(230,970)	(207,610)	(223,636)
	Less shareholders' accrued interest in the long-term business	10,492	9,511	10,176
		(220,478)	(198,099)	(213,460)
Total net assets		7,10	18,993	16,672
				18,207
Share capital		127	127	127
Share premium		1,871	1,856	1,856
IFRS basis shareholders' reserves		6,503	5,178	6,048
Total IFRS basis shareholders' equity	7	8,501	7,161	8,031
Additional EEV basis retained profit	7	10,492	9,511	10,176
Shareholders' equity (excluding non-controlling interests)	7,10	18,993	16,672	18,207

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

Notes on the EEV basis results

1 Basis of preparation, methodology and accounting presentation

The EEV basis results have been prepared in accordance with the EEV Principles issued by the European Insurance CFO Forum in May 2004. Where appropriate, the EEV basis results include the effects of adoption of International Financial Reporting Standards (IFRS).

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

The EEV basis results for 2011 and 2010 half years are unaudited. The 2010 full year results have been derived from the EEV basis results supplement to the Company's statutory accounts for 2010. The supplement included an unqualified audit report from the auditors.

a Covered business

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

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

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

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

The PSPS deficit funding liability attaching to the shareholder-backed business is included in the total for Other operations, reflecting the fact that the deficit funding is being paid for by the parent company, Prudential plc. The changes in financial position of the Scottish Amicable and M&G pension schemes are reflected in the EEV results for UK insurance operations and Other operations respectively.

b Methodology

i Embedded value

Overview

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

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

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

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

Valuation of in-force and new business

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

Best estimate assumptions

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

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

Principal economic assumptions

For the Group's UK and US operations, the EEV basis results for all periods shown have been determined using economic assumptions where the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on government bonds (the 'active' basis).

For Asian operations, the half year 2011 and full year 2010 EEV basis results have been determined on the 'active' basis of assumption setting. For half year 2010 the EEV basis results for Japan, Korea and US dollar denominated business written in Hong Kong were determined on the 'active' basis. For other Asian countries the investment return assumptions and risk discount rates for half year 2010 were based on an assessment of longer-term economic conditions (the 'passive' basis). The altered approach with effect from full year 2010 to determine the EEV basis results for all Asian territories on an active basis of economic assumption setting is in line with the Group's other operations, and reflects the fact that markets in a number of Asian countries are becoming increasingly developed.

The effect of the change in full year 2010 to move to an 'active' basis is as follows:

Effect on:

Full Year

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

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

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

New Business

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

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

Valuation movements on investments

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

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

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

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

Cost of capital

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

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

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

Financial options and guarantees

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

Asian operations

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

There are also various non-participating long-term products with guarantees. The principal guarantees are those for whole of life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequently with market conditions. Such contracts are written in the Korean life operations.

US operations (Jackson)

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

Fixed annuities provide that, at Jackson's discretion, it may reset the interest rate credited to policyholders' accounts, subject to a guaranteed minimum. The guaranteed minimum return varies from 1.0 per cent to 5.5 per cent (half year and full year 2010: 1.5 per cent to 5.5 per cent), depending on the particular product, jurisdiction where issued, and date of issue. At half year 2011, 85 per cent (half year and full year 2010: 83 per cent) of the account values on fixed annuities relates to policies with guarantees of 3 per cent or less. The average guarantee rate is 2.9 per cent for all periods throughout these results.

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

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

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

UK insurance operations

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

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses: annual and final. Annual bonuses are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits fund held a provision on the Pillar I Peak 2 basis of £26 million at 30 June 2011 (30 June 2010: £31 million; 31 December 2010: £24 million) to honour guarantees on a small amount of guaranteed annuity option products.

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

The Group's main exposure to guaranteed annuity options in the UK is through SAIF and a provision on the Pillar I Peak 2 basis of £327 million (half year 2010: £321 million; full year 2010: £336 million) was held in SAIF at 30

June 2011 to honour the guarantees. As SAIF is a separate sub-fund of the Prudential Assurance Company long-term fund which is attributable to policyholders of the fund, the movement in the provision has no direct impact on shareholders.

Time value

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

Where appropriate, a full stochastic valuation has been undertaken to determine the time value of the financial options and guarantees.

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

ii Level of required capital

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

- Asian operations: the level of required capital has been set at the higher of local statutory requirements and the economic capital requirement;
- US operations: the level of required capital has been set to an amount at least equal to 235 per cent of the risk-based capital required by the National Association of Insurance Commissioners (NAIC) at the Company Action Level (CAL); and
- UK insurance operations: the capital requirements are set at the higher of Pillar I and Pillar II requirements for shareholder-backed business of UK insurance operations as a whole, which for half year 2011 and 2010 was Pillar I.

iii Allowance for risk and risk discount rates

Overview

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

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

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

Market risk allowance

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

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

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

Additional credit risk allowance

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

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

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

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

Asian operations

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

US business

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

The risk discount rate incorporates an additional allowance for credit risk premium and short-term defaults. In determining this allowance a number of factors have been considered. These factors, in particular, include:

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

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

After taking these and other more detailed factors into account and, based on market conditions from 2009 to half year 2011, the risk discount rate for general account business includes an additional allowance of 150 basis points for credit risk. For VA business, the additional allowance increase has been set at 20 per cent (equivalent to 30 basis points) of the increase for non-VA business to reflect the fact that a proportion of the VA business is allocated to holdings of general account debt securities. The additional allowance to be applied in future reporting periods will be altered, as necessary, for future credit conditions and as the business in force alters over time.

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

UK business

a Shareholder-backed annuity business

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

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

b With-profit fund PAL annuity business

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

c With-profit fund holdings of debt securities

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

Allowance for non-diversifiable non-market risks

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

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

iv Management actions

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

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

v With-profits business and the treatment of the estate

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

vi Pension costs

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

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

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

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

vii Debt capital

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

viii Foreign currency translation

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

c Accounting presentation

i Analysis of profit before tax

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

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

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

ii Operating profit

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

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

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

iii Effect of changes in operating assumptions

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

iv Unwind of discount and other expected returns

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

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

v Pension costs

Profit before tax

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

Actuarial and other gains and losses

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

- the difference between actual and expected return on the scheme assets;

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

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

vi Effect of changes in economic assumptions

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

vii Taxation

The profit for the period for covered business is in most cases calculated initially at the post-tax level. The post-tax profit for covered business is then grossed up for presentation purposes at the rates of tax applicable to the countries and periods concerned. In the UK the rate applied for half year 2011 is 26 per cent (half year 2010: 28 per cent; full year 2010: 27 per cent). For Jackson, the US federal tax rate of 35 per cent is applied to gross up movements on the value of in-force business. The overall tax rate includes the impact of tax effects determined on a local regulatory basis. For Asia, similar principles apply subject to the availability of taxable profits. Tax payments and receipts included in the projected cash flows to determine the value of in force business are calculated using rates that have been substantively enacted by the end of the reporting period. Possible future changes of rate are not anticipated.

viii Inter-company arrangements

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

ix Foreign exchange rates

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

	Closing rate at 30 Jun 2011	Average for the 6 months to 30 Jun 2011	Closing rate at 30 Jun 2010	Average for the 6 months to 30 Jun 2010	Closing rate at 31 Dec 2010	Average for 2010
Local currency: £	2011	2011	2010	2010	2010	for 2010
China	10.38	10.57	10.15	10.41	10.32	10.46
Hong Kong	12.49	12.58	11.65	11.85	12.17	12.01
India	71.77	72.74	69.49	69.83	70.01	70.66
Indonesia	13,767.54	14,133.01	13,562.15	14,007.05	14,106.51	14,033.41
Korea	1,714.06	1,780.29	1,828.18	1,760.68	1,776.86	1,786.23
Malaysia	4.85	4.90	4.84	5.04	4.83	4.97
Singapore	1.97	2.03	2.09	2.13	2.01	2.11
Taiwan	46.11	47.00	48.07	48.61	45.65	48.65
Vietnam	33,048.21	33,110.56	28,545.59	28,806.01	30,526.26	29,587.63
US	1.61	1.62	1.50	1.53	1.57	1.55

2 Analysis of new business contribution note iv

Edgar Filing: PRUDENTIAL PLC - Form 6-K

New business premiums	Period ended 30 Jun 2011					New business margin	
			Present			note i	
			Annual	value of	new		
	Single	Regular	premium and	business	Pre-tax new	(APE)	(PVNBP)
£m	£m	contribution	premiums	business	(APE)	(PVNBP)	
		equivalents	(PVNBP)	contribution	notes ii, iii		
		(APE)			£m	%	%
		note i	note i				
		£m	£m				
Asian operations	744	668	743	3,939	465	63	11.8
US operations	6,615	10	672	6,689	458	68	6.8
UK insurance							
operations	2,520	157	409	3,264	146	36	4.5
Total	9,879	835	1,824	13,892	1,069	59	7.7

New business premiums	Period ended 30 Jun 2010					New business margin	
			Present			note i	
			Annual	value of	new		
	Single	Regular	premium and	business	Pre-tax new	(APE)	(PVNBP)
£m	£m	contribution	premiums	business	(APE)	(PVNBP)	
		equivalents	(PVNBP)	contribution	notes ii, iii		
		(APE)			£m	%	%
		note i	note i				
		£m	£m				
Asian							
operationsnote v	430	670	713	3,316	396	56	11.9
US operations	5,493	11	560	5,569	361	64	6.5
UK insurance							
operations	2,438	138	382	3,081	135	35	4.4
Total	8,361	819	1,655	11,966	892	54	7.5

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

	New business margin (APE %)		
	Half year	Half year	Full year
	2011	2010	2010
Asian operations:note v			
China	40	44	47
Hong Kong	72	72	74
India	21	20	20
Indonesia	76	71	75
Korea	41	45	31
Taiwan	26	19	13
Other	73	74	79
Weighted average for all Asian operations	63	56	60

Notes

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

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

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

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

The tables for half year and full year 2010 exclude new business sales and contributions for Japanese insurance v operations in which the Company ceased selling new business from 15 February 2010.

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

The new business margin for UK operations for full year 2010 of 45 per cent reflects the signing of a bulk annuity vii buy-in insurance agreement with an APE of £88 million.

3 Operating profit from business in force

Group Summary

Edgar Filing: PRUDENTIAL PLC - Form 6-K

	Period ended 30 Jun 2011 £m			Total
	Asian operations	US operations	UK operations	
	note i	note ii	note iii	
Unwind of discount and other expected returns	333	203	289	825
Effect of change in operating assumptions	(18)	14	-	(4)
Experience variances and other items	(6)	156	102	252
Total	309	373	391	1,073

	Period ended 30 Jun 2010 £m			Total
	Asian operations	US operations	UK operations	
	note i	note ii	note iii	
Unwind of discount and other expected returns	300	181	292	773
Effect of change in operating assumptions	(14)	3	-	(11)
Experience variances and other items	(45)	122	22	99
Total	241	306	314	861

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

Notes

Analysis by business unit