Section 6

European Embedded Value (EEV) basis results

Notes on the EEV basis results

6

Description of EEV basis reporting

In broad terms, IFRS profits for long-term business reflect the aggregate of results on a traditional accounting basis. By contrast, embedded value is a way of reporting the value of the life insurance business.

The European Embedded Value principles were published by the CFO Forum of major European insurers in October 2005. The principles provide consistent definitions, a framework for setting actuarial assumptions and an approach to the underlying methodology and disclosures.

Results prepared under the EEV principles capture the discounted value of future profits expected to arise from the current book of long-term business. The results are prepared by projecting cash flows, by product, using best estimate assumptions for all relevant factors. Furthermore, in determining these expected profits full allowance is made for the risks attached to their emergence and the associated cost of capital, and takes into account recent experience in assessing likely future persistency, mortality and expenses. Further details are explained in note 15.

European Embedded Value (EEV) basis results

Pre-tax operating profit based on longer-term investment returns

Results analysis by business area

	Note	2013 £m	2012 £m note (ii)
Asia operations			
New business	2	1,460	1,266
Business in force*	3	927	692
Long-term business*		2,387	1,958
Eastspring investments*		74	69
Development expenses		(2)	(7)
Total*		2,459	2,020
US operations			
New business	2	1,086	873
Business in force	3	1,135	737
Long-term business		2,221	1,610
Broker-dealer and asset management		59	39
Total		2,280	1,649
UK operations			
New business	2	297	313
Business in force	3	736	553
Long-term business		1,033	866
General insurance commission		29	33
Total UK insurance operations		1,062	899
M&G (including Prudential Capital)		441	371
Total		1,503	1,270
Other income and expenditure			
Investment return and other income		10	13
Interest payable on core structural borrowings		(305)	(280)
Corporate expenditure		(263)	(231)
Unwind of expected asset management margin note (i)		(61)	(56)
Total		(619)	(554)
Solvency II implementation costs		(31)	(50)
Restructuring costs		(12)	(22)
Pre-tax operating profit based on longer-term investment returns*		5,580	4,313
Analysed as profits (losses) from:			
New business	2	2,843	2,452
Business in force*	3	2,798	1,982
Long-term business*		5,641	4,434
Asset management*		574	479
Other results		(635)	(600)
Total*		5,580	4,313

* The Group has adopted the new accounting standard on 'Joint arrangements' (IFRS 11) from 1 January 2013. This has resulted in a reallocation of £(8) million in 2013 (2012: £(6) million) from the tax charge on operating profit based on longer-term investment returns to the pre-tax result for Eastspring investments, with no effect on the net of tax EEV basis results. In addition, the Group agreed in July 2013 to sell, dependent on regulatory approval, its closed book life insurance business in Japan. Accordingly, the presentation of the 2012 comparative EEV basis results and related notes have been adjusted from those previously published for the retrospective application of this standard and for the reclassification of the result attributable to the held for sale Japan life business, as described in note 18. This approach has been adopted consistently throughout this supplementary information.

Notes

(i) The value of profits or losses from asset management and service companies that support the Group's covered insurance businesses (as defined in note 15(a)) 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 the management of internal and external funds. For EEV basis reporting, Group shareholders' other income is adjusted to deduct the unwind of the expected profit margin for the year arising from the management of the assets of the covered business by the Group's asset management businesses. The deduction is on a basis consistent with that used for projecting the results for covered insurance business. Group operating profit accordingly includes the variance between actual and expected profit in respect of management of the covered business assets.

(ii) The comparative results have been prepared using previously reported average exchange rates for the year.

Summarised consolidated income statement

	Note	2013 £m	2012 £m
Pre-tax operating profit based on longer-term investment returns			
Asia operations*		2,459	2,020
US operations		2,280	1,649
UK operations:			
UK insurance operations		1,062	899
M&G (including Prudential Capital)		441	371
		1,503	1,270
Other income and expenditure		(619)	(554)
Solvency II implementation costs		(31)	(50)
Restructuring costs		(12)	(22)
Pre-tax operating profit based on longer-term investment returns*		5,580	4,313
(Loss) profit attaching to held for sale Japan life business*	4	(35)	21
Short-term fluctuations in investment returns*	5	(819)	510
Effect of changes in economic assumptions*	6	821	(2)
Mark to market value movements on core borrowings		152	(380)
Costs of domestication of Hong Kong branch	12	(35)	–
Gain on acquisition of REALIC†	4	–	453
Gain on dilution of Group's holdings†		–	42
Total non-operating profit*	9	84	644
Profit before tax attributable to shareholders (including actual investment returns)*		5,664	4,957
Tax attributable to shareholders' profit*	10	(1,306)	(1,188)
Profit for the year attributable to equity holders of the Company*		4,358	3,769

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of IFRS 11 and revised 'Employee benefits' (IAS 19) and for the reclassification of the result attributable to the held for sale Japan life business – see note 18.
† During 2012, the Group completed the acquisition of REALIC generating a gain of £453 million and M&G reduced its holding in PPM South Africa resulting in a reclassification from a subsidiary to an associate and a gain on dilution of £42 million.

Earnings per share (in pence)

	Note	2013	2012*
Based on post-tax operating profit including longer-term investment returns of £4,204 million (2012*: £3,174 million)	11	165.0p	124.9p
Based on post-tax profit of £4,358 million (2012*: £3,769 million)	11	171.0p	148.3p

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of IFRS 11 and revised IAS 19 – see note 18.

Dividends per share (in pence)

	2013	2012
Dividends relating to reporting year:		
Interim dividend	9.73p	8.40p
Final dividend	23.84p	20.79p
Total	33.57p	29.19p
Dividends declared and paid in reporting year:		
Current year interim dividend	9.73p	8.40p
Final dividend for prior year	20.79p	17.24p
Total	30.52p	25.64p

European Embedded Value (EEV) basis results continued

Movement in shareholders' equity

	Note	**2013** £m	**2012** £m
Profit for the year attributable to equity shareholders*		4,358	3,769
Items taken directly to equity:			
Exchange movements on foreign operations and net investment hedges:			
Exchange movements arising during the year		(1,077)	(467)
Related tax		–	(2)
Dividends		(781)	(655)
New share capital subscribed		6	17
Post-tax shareholders' share of actuarial and other gains and losses on defined benefit pension schemes*		(53)	44
Reserve movements in respect of share-based payments		98	42
Treasury shares:			
Movement in own shares in respect of share-based payment plans		(10)	(13)
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		(31)	36
Mark to market value movements on Jackson assets backing surplus and required capital:			
Mark to market value movements arising during the year		(149)	53
Related tax		52	(18)
Net increase in shareholders' equity	9	2,413	2,806
Shareholders' equity at beginning of year	9	22,443	19,637
Shareholders' equity at end of year	9	24,856	22,443

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of revised IAS 19 – see note 18.

	31 Dec 2013 £m			**31 Dec 2012** £m		
Comprising	**Long-term business operations**	**Asset management and other operations**	**Total**	**Long-term business operations**	**Asset management and other operations**	**Total**
Asia operations:						
Net assets of operations	10,305	194	10,499	9,462	207	9,669
Acquired goodwill	231	61	292	239	61	300
	10,536	255	10,791	9,701	268	9,969
US operations:						
Net assets of operations	6,966	118	7,084	6,032	108	6,140
Acquired goodwill	–	16	16	–	16	16
	6,966	134	7,100	6,032	124	6,156
UK insurance operations:						
Net assets of operations	7,342	22	7,364	6,772	25	6,797
M&G:						
Net assets of operations	–	449	449	–	392	392
Acquired goodwill	–	1,153	1,153	–	1,153	1,153
	–	1,602	1,602	–	1,545	1,545
	7,342	1,624	8,966	6,772	1,570	8,342
Other operations:						
Holding company net borrowings at market value[note 7]	–	(2,373)	(2,373)	–	(2,282)	(2,282)
Other net assets	–	372	372	–	258	258
	–	(2,001)	(2,001)	–	(2,024)	(2,024)
Shareholders' equity at end of year	24,844	12	24,856	22,505	(62)	22,443
Representing:						
Net assets (liabilities)	24,613	(1,218)	23,395	22,266	(1,292)	20,974
Acquired goodwill	231	1,230	1,461	239	1,230	1,469
	24,844	12	24,856	22,505	(62)	22,443

Net asset value per share

	31 Dec 2013	31 Dec 2012
Based on EEV basis shareholders' equity of £24,856 million (2012: £22,443 million) (in pence)	971p	878p
Number of issued shares at year end (millions)	2,560	2,557
Return on embedded value*	19%	16%

* Return on embedded value is based on EEV post-tax operating profit, as shown in note 11, as a percentage of opening EEV basis shareholders' equity.

Summary statement of financial position

	Note	31 Dec 2013 £m	31 Dec 2012 £m
Total assets less liabilities, before deduction for insurance funds*		288,826	271,768
Less insurance funds†			
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds*		(279,176)	(261,409)
Less shareholders' accrued interest in the long-term business		15,206	12,084
		(263,970)	(249,325)
Total net assets	9	24,856	22,443
Share capital		128	128
Share premium		1,895	1,889
IFRS basis shareholders' reserves		7,627	8,342
Total IFRS basis shareholders' equity	9	9,650	10,359
Additional EEV basis retained profit	9	15,206	12,084
Total EEV basis shareholders' equity (excluding non-controlling interests)	9	24,856	22,443

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of IFRS 11 - see note 18.
† Including liabilities in respect of insurance products classified as investment contracts under IFRS 4. For 2013 the policyholder liabilities of the held for sale Japan life business are included in total assets less liabilities, before deduction for insurance funds.

The supplementary information on pages 296 to 330 was approved by the Board of directors on 11 March 2014.

Paul Manduca
Chairman

Tidjane Thiam
Group Chief Executive

Nic Nicandrou
Chief Financial Officer

Notes on the EEV basis results

1 Basis of preparation

The EEV basis results have been prepared in accordance with the EEV Principles issued by the European Insurance CFO Forum in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005. 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. Except for the presentational change for the results of the held for sale Japan life business and the consequential effects of the changes in accounting policies for IFRS reporting in respect of employee benefits (IAS 19) and joint venture operations (IFRS 11), as described in note 18, the 2012 results have been derived from the EEV basis results supplement to the Company's statutory accounts for 2012.

A detailed description of the EEV methodology and accounting presentation is provided in note 15.

2 Analysis of pre-tax new business contribution

	2013				
	Annual premium and contribution equivalents (APE) note 17 £m	**Present value of new business premiums (PVNBP)** note 17 £m	**Pre-tax new business contribution** £m	**Pre-tax new business margin**	
				APE %	**PVNBP** %
Asia operations	**2,125**	**11,375**	**1,460**	**69**	**12.8**
US operations	**1,573**	**15,723**	**1,086**	**69**	**6.9**
UK insurance operations	**725**	**5,978**	**297**	**41**	**5.0**
Total	**4,423**	**33,076**	**2,843**	**64**	**8.6**

	2012				
	Annual premium and contribution equivalents (APE) note 17 £m	**Present value of new business premiums (PVNBP)** note 17 £m	**Pre-tax new business contribution** £m	**Pre-tax new business margin**	
				APE %	**PVNBP** %
Asia operations	1,897	10,544	1,266	67	12.0
US operations	1,462	14,600	873	60	6.0
UK insurance operations	836	7,311	313	37	4.3
Total	4,195	32,455	2,452	58	7.6

	Pre-tax new business contribution	
	2013 £m	**2012** £m
Asia operations:		
China	**37**	26
Hong Kong	**354**	210
India	**18**	19
Indonesia	**480**	476
Korea	**33**	26
Taiwan	**37**	48
Other	**501**	461
Total Asia operations	**1,460**	1,266

3 Pre-tax operating profit from business in force

(i) Group summary

	2013 £m				2012 £m			
	Asia operations note (ii)	US operations note (iii)	UK insurance operations note (iv)	Total	Asia operations* note (ii)	US operations note (iii)	UK insurance operations note (iv)	Total*
Unwind of discount and other expected returns	846	608	547	2,001	595	412	482	1,489
Effect of changes in operating assumptions	17	116	122	255	22	35	87	144
Experience variances and other items	64	411	67	542	75	290	(16)	349
Total	927	1,135	736	2,798	692	737	553	1,982

* The 2012 comparative results have been adjusted retrospectively from those previously published for the reclassification of the result attributable to the held for sale Japan life business – see note 18.

(ii) Asia operations

	2013 £m	2012* £m
Unwind of discount and other expected returns note (a)	846	595
Effect of changes in operating assumptions:		
Mortality and morbidity note (b)	35	79
Persistency and withdrawals note (c)	(30)	(24)
Expense note (d)	(7)	(45)
Other	19	12
	17	22
Experience variance and other items:		
Mortality and morbidity note (e)	42	57
Persistency and withdrawals note (f)	44	52
Expense note (g)	(26)	(30)
Other	4	(4)
	64	75
Total Asia operations	927	692

* The 2012 comparative results have been adjusted retrospectively from those previously published for the reclassification of the result attributable to the held for sale Japan life business – see note 18.

Notes

(a) The increase in unwind of discount and other expected returns of £251 million from £595 million in 2012 to £846 million in 2013 reflects a £140 million effect of higher risk discount rates, driven by the increase in long-term interest rates, together with an effect of £111 million arising from the growth in the opening in-force value (adjusted for assumption changes) on which the discount rates are applied, partially offset by a £(21) million reduction due to unfavourable exchange rate movements, particularly in Indonesia, and a £21 million increase in the return on net worth.

(b) In 2013 the credit of £35 million for mortality and morbidity assumption changes mainly reflects a beneficial effect arising from the renegotiation of a reinsurance agreement in Indonesia. The 2012 credit of £79 million primarily reflected mortality improvements in Hong Kong and Singapore and revised assumptions for critical illness business in Singapore.

(c) The charge for persistency and withdrawals assumption changes reflects a number of offsetting items including for 2013, the effect of strengthening lapse and premium holiday assumptions in Korea.

(d) In 2012 the charge of £(45) million for expense assumption changes principally arose in Malaysia and reflected changes to the pension entitlements of agents.

(e) The favourable effect of mortality and morbidity experience in 2013 of £42 million (2012: £57 million) reflects continued better than expected experience, principally arising in Hong Kong, Indonesia and Singapore.

(f) The persistency and withdrawals experience variance in 2013 of £44 million (2012: £52 million) principally reflects favourable experience in Hong Kong and Indonesia.

(g) The negative expense experience variance of £(26) million in 2013 (2012: £(30) million) principally reflects expense overruns for operations which are currently sub-scale (China, Malaysia Takaful and Taiwan) and in India where the business model is being adapted in response to the regulatory changes introduced in recent years.

Notes on the EEV basis results continued

3 Pre-tax operating profit from business in force continued

(iii) US operations

	2013 £m	**2012** £m
Unwind of discount and other expected returns[note (a)]	608	412
Effect of changes in operating assumptions:		
Persistency[note (b)]	72	45
Variable annuity fees[note (c)]	50	(19)
Other	(6)	9
	116	35
Experience variances and other items:		
Spread experience variance[note (d)]	274	205
Amortisation of interest-related realised gains and losses[note (e)]	89	91
Other[note (f)]	48	(6)
	411	290
Total US operations[note (g)]	1,135	737

Notes

(a) The increase in unwind of discount and other expected returns of £196 million from £412 million for 2012 to £608 million in 2013 includes a £125 million effect of the increase in opening value of in-force business (after assumption changes), together with the positive effect of higher risk discount rates of £65 million and a £6 million increase in the return on net worth.

(b) The effect of changes in persistency assumptions of £72 million in 2013 (2012: £45 million) primarily relates to a reduction in lapse rates following the end of the surrender charge period, principally for variable annuity business.

(c) The effect of the change of assumption for variable annuity fees represents the capitalised value of the change in the projected policyholder advisory fees, which vary according to the size and the mix of variable annuity funds.

(d) The spread assumption for Jackson is determined on a longer-term basis, net of provision for defaults (see note 16(ii)(b)). The spread experience variance in 2013 of £274 million (2012: £205 million) includes the positive effect of transactions undertaken to more closely match the overall asset and liability duration.

(e) The amortisation of interest-related gains and losses reflects the fact that when bonds that are neither impaired nor deteriorating are sold and reinvested there will be a consequent change in the investment yield. The realised gain or loss is amortised into the result over the period when the bonds would have otherwise matured to better reflect the long-term returns included in operating profits.

(f) The credit of £48 million for other changes in experience variances and other items mainly reflects the positive persistency experience variance of £62 million (2012: £21 million) across all products.

(g) The result includes a full year contribution from the REALIC book of business of £61 million (2012: four months of £19 million).

(iv) UK insurance operations

	2013 £m	**2012** £m
Unwind of discount and other expected returns[note (a)]	547	482
Effect of change in UK corporate tax rate[note (b)]	122	87
Other items[note (c)]	67	(16)
Total UK insurance operations	736	553

Notes

(a) The increase in unwind of discount and other expected returns of £65 million from £482 million in 2012 to £547 million for 2013 reflects a £34 million effect of higher discount rates, driven by the increase in gilt yields, a £24 million increase in the return on net worth and an effect of £7 million arising from the growth in the opening value of in-force.

(b) For 2013, the beneficial effect of the change in UK corporate tax rates of £122 million (2012: £87 million) reflects the combined effect of the reductions in corporate rates from 23 per cent to 21 per cent from April 2014 and 21 per cent to 20 per cent from April 2015 (2012: from 25 per cent to 23 per cent) which were both enacted in July 2013. Consistent with the Group's approach of grossing up the movement in the post-tax value of in-force business for shareholder tax, the £122 million (2012: £87 million) benefit is presented gross.

(c) Other items of £67 million for 2013 includes the positive effects of rebalancing the investment portfolio backing annuity business. In 2012 the negative effect of £(16) million included a charge of £(52) million for the strengthening of mortality assumptions, net of reserve releases and the effects of portfolio rebalancing for annuity business.

4 Business acquisitions and disposals

a Acquisition of Thanachart Life Assurance Company Limited and bancassurance partnership agreement with Thanachart Bank

On 3 May 2013, the agreement Prudential plc, through its subsidiary Prudential Life Assurance (Thailand) Public Company Limited (Prudential Thailand), entered into in November 2012 to establish an exclusive 15-year partnership with Thanachart Bank Public Company limited (Thanachart Bank) to develop jointly their bancassurance business in Thailand was launched. At the same time Prudential Thailand completed the acquisition of 100 per cent of the voting interest in Thanachart Life Assurance Company Limited (Thanachart Life), a wholly-owned life insurance subsidiary of Thanachart Bank.

The consideration for the transaction is THB 18.981 billion (£412 million), of which THB 17.500 billion (£380 million) was settled in cash on completion in May 2013 with a further payment of THB 0.946 billion (£20 million), for adjustments to reflect the net asset value as at completion date, paid in July 2013. In addition a deferred payment of THB 0.535 billion (£12 million) is payable 12 months after completion. The acquired assets are comprised of:

	£m
Acquired assets:	
Net worth (including acquisition of distribution rights)	**386**
Value of in force acquired	**26**
Transaction consideration	**412**

The purchase consideration paid was equivalent to the fair value of the acquired assets and liabilities assumed. No goodwill has been recognised.

b Acquisition of Reassure America Life Insurance Company in 2012

On 4 September 2012, the Group through its indirect wholly-owned subsidiary, Jackson completed the acquisition of 100 per cent issued share capital of SRLC America Holding Corp. and its primary operating subsidiary, Reassure America Life Insurance Company (REALIC). REALIC is a US-based insurance company whose business model was to acquire, through purchase or reinsurance, closed blocks of insurance business, primarily life assurance risks. REALIC did not and does not write new business.

The gain of £453 million reflects the fair value of the acquired business as determined by applying the same methodology as applied for Jackson's non-variable annuity business. A risk discount rate of 4.3 per cent at the date of acquisition on 4 September 2012 was used.

c Agreement to sell Japan life business

On 16 July 2013, the Group reached an agreement to sell, subject to regulatory approval, the life insurance business in Japan, PCA Life Insurance Company Limited, which was closed to new business in 2010, to SBI Holdings Inc. for US$85 million (£51 million at 31 December 2013 closing exchange rate) with related expenses of £3 million. Consistent with the 'held for sale' classification of the business for IFRS reporting, the EEV carrying value has been set to £48 million at 31 December 2013. For 2013 the result for the year, together with the adjustment to the carrying value have given rise to an aggregate loss of £(35) million which has been included in non-operating profit. Consistent with this treatment, the presentation of the comparative results has been adjusted retrospectively from those previously published.

5 Short-term fluctuations in investment returns

Short-term fluctuations in investment returns, net of the related change in the time value of cost of options and guarantees, arise as follows:

(i) Group Summary

	2013 £m	**2012** £m
Insurance operations:		
Asia* note (ii)	**(405)**	362
US note (iii)	**(422)**	(254)
UK note (iv)	**35**	315
	(792)	423
Other operations:		
Other* note (v)	**(27)**	119
Economic hedge value movement note (vi)	**–**	(32)
Total*	**(819)**	510

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of revised IAS 19 and for the reclassification of the results attributable to the held for sale Japan life business - see note 18.

Notes on the EEV basis results continued

5 Short-term fluctuations in investment returns continued

(ii) Asia operations

For 2013, the negative short-term fluctuations in investment returns of £(405) million principally arise in Hong Kong of £(223) million and in Singapore of £(96) million, due to unrealised value reductions on bonds, arising from the increase in long-term interest rates, and in Indonesia of £(52) million for a decrease in future expected fee income for unit-linked business, driven by falls in equity markets.

For 2012, the positive short-term fluctuations in investment returns of £362 million in Asia operations were driven by unrealised gains on bonds and higher equity markets which principally arose in Hong Kong of £139 million mainly relating to positive returns on bonds backing participating business, Singapore of £114 million primarily relating to increasing future expected fee income for unit-linked business and unrealised gains on bonds, Taiwan of £56 million for unrealised gains on bonds and CDOs and India of £30 million.

(iii) US operations

The short-term fluctuations in investment returns for US operations comprise the following items:

	2013 £m	**2012** £m
Investment return related experience on fixed income securities[note (a)]	**21**	(99)
Investment return related impact due to changed expectation of profits on in-force variable annuity business in future periods based on current period separate account return, net of related hedging activity[note (b)]	**(580)**	(183)
Other items including actual less long-term return on equity based investments[note (c)]	**137**	28
Total US operations	**(422)**	(254)

Notes

(a) The credit (charge) relating to fixed income securities comprises the following elements: (1) the excess of actual realised gains (losses) over the amortisation of interest related realised gains and losses recorded in the profit and loss account; (2) credit loss experience (versus the longer-term assumption); and (3) the impact of de-risking activities within the portfolio.

(b) This item reflects the net impact of variances in projected future fees and future benefit costs arising from the effect of market fluctuations on the growth in separate account asset values in the current reporting period and related hedging activity arising from realised and unrealised gains and losses on equity related hedges and interest rate options.

(c) Other items of £137 million in 2013 primarily reflects a beneficial impact of the excess of actual over assumed return from investments in limited partnerships.

(iv) UK insurance operations

The short-term fluctuations in investment returns for UK insurance operations arise from the following types of business:

	2013 £m	**2012** £m
Shareholder-backed annuity[note (a)]	**(72)**	(3)
With-profits, unit-linked and other[note (b)]	**107**	318
Total UK insurance operations	**35**	315

Notes

(a) Short-term fluctuations in investment returns for shareholder-backed annuity business comprise: (1) gains/losses on surplus assets compared to the expected long-term rate of return reflecting reductions/increases in corporate bond and gilt yields; (2) the difference between actual and expected default experience; and (3) the effect of mismatching for assets and liabilities of different durations and other short-term fluctuations in investment returns.

(b) The short-term fluctuations in investment returns for with-profits, unit-linked and other business primarily arise from the excess of actual over expected returns for with-profits business. The total return on the fund (including unallocated surplus) in 2013 was 8 per cent compared to an assumed rate of return of 6 per cent (2012: 10 per cent total return compared to assumed rate of 5 per cent). In addition, the amount for 2013 includes the effect of a partial hedge of future shareholder transfers expected to emerge from the UK's with-profits sub-fund taken out during the year. This hedge reduces the risks arising from equity market declines.

(v) Other items

Short-term fluctuations in investment returns of other operations were negative £(27) million (2012: positive £119 million) representing principally unrealised value movements on investments and foreign exchange items.

(vi) Economic hedge value movements

This item represents the cost of short-dated hedge contracts taken out in the first half of 2012 to provide downside protection against severe equity market falls through a period of particular uncertainty with respect to the Eurozone. The hedge contracts were terminated in the second half of 2012.

6 Effect of changes in economic assumptions

The effects of changes in economic assumptions for in-force business, net of the related change in the time value of cost of options and guarantees, included within profit before tax (including actual investment returns) arise as follows:

(i) Group summary

	2013 £m	2012 £m
Asia operations* note(ii)	283	(135)
US operations note(iii)	372	85
UK insurance operations note(iv)	166	48
Total*	821	(2)

* The 2012 comparative results have been adjusted retrospectively from those previously published for the reclassification of the result attributable to the held for sale Japan life business – see note 18.

(ii) Asia operations

The effect of changes in economic assumptions for Asia operations in 2013 of £283 million primarily reflects the overall impact of the increase in long-term interest rates in the year, principally arising in Hong Kong of £361 million, Singapore of £107 million and Taiwan of £99 million mainly due to the increase in fund earned rates for participating business. There are partial offsets arising in Indonesia of £(237) million and in Malaysia of £(77) million, mainly reflecting the negative impact of calculating health and protection future profits at a higher discount rate.

The charge of £(135) million in 2012 for the effect of changes in economic assumptions principally arose in Hong Kong of £(320) million, primarily reflecting the effect on projected cash flows of de-risking the asset portfolio and the reduction in fund earned rates on participating business, driven by the very low interest rate environment, and in Vietnam of £(47) million, following the fall in bond yields. There were partial offsets totalling £232 million, principally arising in Malaysia and Indonesia, mainly reflecting the positive impact of calculating projected health and protection profits at a lower rate, driven by the decrease in risk discount rates.

(iii) US operations

The effect of changes in economic assumptions for US operations reflects the following:

	2013 £m	2012 £m
Effect of changes in 10-year treasury rates and beta:		
Fixed annuity and other general account business note(a)	(375)	20
Variable annuity business note(b)	587	(83)
Decrease in additional allowance for credit risk note(c)	160	148
Total US operations note(d)	372	85

Notes

(a) For fixed annuity and other general account business the charge of £(375) million in 2013 principally arises from the effect of a higher discount rate on the opening value of the in-force book, driven by the 130 basis points increase in the risk-free rate. The projected cash flows for this business principally reflect projected spread, with secondary effects on the cash flows also resulting from changes to assumed future yields and resulting policyholder behaviour. The credit of £20 million in 2012 reflected a 10 basis point decrease in the risk-free rate, partially offset by the effect for the acquired REALIC book (reflecting a 20 basis point increase in the risk-free rate from the 4 September acquisition date to 31 December 2012).

(b) For variable annuity business, the credit of £587 million principally reflects an increase in projected fee income and a decrease in projected benefit costs, arising from the increase in the rate of assumed future return on the underlying separate account assets, driven by the 130 basis points increase in the risk-free rate. There is a partial offset arising from the increase in the discount rate applied to those cash flows. The charge of £(83) million in 2012 reflected a decrease in the risk-free rate of 10 basis points.

(c) For 2013 the £160 million (2012: £148 million) effect of the decrease in the additional allowance for credit risk within the risk discount rate reflected the reduction in credit spreads and represented a 50 basis points decrease for spread business and a 10 basis points decrease for variable annuity business, representing the proportion of business invested in the general account (as described in note 15(b)(iii)).

(d) The total effect of changes in economic assumptions for US operations of a credit of £372 million for 2013 includes a pre-tax charge of £(20) million for the effect of the change in required capital from 235 per cent to 250 per cent of risk-based capital (see note 15(b)(ii)).

Notes on the EEV basis results continued

6 Effect of changes in economic assumptions continued

(iv) UK insurance operations

The effect of changes in economic assumptions of a credit of £166 million for UK insurance operations for 2013 comprises the following:

	2013 £m	2012 £m
Effect of changes in expected long-term rates of return, risk discount rates and other changes:		
Shareholder-backed annuity business[note (a)]	(70)	140
With-profits and other business[note (b)]	236	(46)
Tax regime[note (c)]	–	(46)
Total UK insurance operations	166	48

Notes

(a) For shareholder-backed annuity business the overall effect of changes in expected long-term rates of return and risk discount rates reflect the combined effects of the changes in economic assumptions, which incorporate a default allowance for both best estimate defaults and in respect of the additional credit risk provisions (as shown in note 16(iii)).

(b) For with-profits and other business the total credit in 2013 of £236 million (2012: charge of £(46) million) includes the net effect of the changes in fund earned rates and risk discount rate (as shown in note 16(iii)), driven by the 120 basis points increase (2012: a reduction of 20 basis points) in the 15-year government bond rate.

(c) In 2012, the effect of the change in tax regime of £(46) million reflected the change in pattern of taxable profits for shareholder-backed annuity business arising from the acceleration of tax payments due to the altered timing of relief on regulatory basis provisions.

7 Net core structural borrowings of shareholder-financed operations

	31 Dec 2013 £m			31 Dec 2012 £m		
	IFRS basis	Mark to market value adjustment	EEV basis at market value	IFRS basis	Mark to market value adjustment	EEV basis at market value
Holding company* cash and short-term investments	(2,230)	–	(2,230)	(1,380)	–	(1,380)
Core structural borrowings – central funds†	4,211	392	4,603	3,126	536	3,662
Holding company net borrowings	1,981	392	2,373	1,746	536	2,282
Core structural borrowings – Prudential Capital	275	–	275	275	–	275
Core structural borrowings – Jackson	150	38	188	153	43	196
Net core structural borrowings of shareholder-financed operations	2,406	430	2,836	2,174	579	2,753

* Including central finance subsidiaries.

† In January 2013, the Company issued US$700 million (£423 million at 31 December 2013 closing exchange rate) perpetual subordinated capital securities. In addition the Company issued £700 million subordinated notes in December 2013.

8 Analysis of movement in free surplus

Free surplus is the excess of the regulatory basis net assets for EEV reporting purposes (net worth) over the capital required to support the covered business. Where appropriate, adjustments are made to the net worth so that backing assets are included at fair value rather than cost so as to comply with the EEV Principles.

	2013 £m			2012* £m
Long-term business and asset management operations note (i)	**Long-term business** note 12	**Asset management and UK general insurance commission** note (iii)	**Free surplus of long-term business, asset management and UK general insurance commission**	**Free surplus of long-term business, asset management and UK general insurance commission**
Underlying movement:				
Investment in new business notes (ii), (viii)	(637)	–	(637)	(618)
Business in force:				
Expected in-force cash flows (including expected return on net assets)	2,150	471	2,621	2,405
Effects of changes in operating assumptions, operating experience variances and other operating items	478	–	478	293
	1,991	471	2,462	2,080
Effect of acquisition of REALIC	–	–	–	(169)
Increase in EEV assumed level of required capital note 12	(58)	–	(58)	–
(Loss) profit attaching to held for sale Japan life business	(40)	–	(40)	31
Other non-operating items note (iv)	(739)	17	(722)	(62)
	1,154	488	1,642	1,880
Net cash flows to parent company note (v)	(1,069)	(272)	(1,341)	(1,200)
Bancassurance agreement and purchase of Thanachart Life notes 4,12	365	–	365	–
Exchange movements, timing differences and other items note (vi)	(187)	(165)	(352)	(412)
Net movement in free surplus	263	51	314	268
Balance at 1 January 2013 note (viii)	2,957	732	3,689	3,421
Balance at 31 December 2013 note (viii)	3,220	783	4,003	3,689
Representing:				
Asia operations	1,185	194	1,379	1,181
US operations	956	118	1,074	1,319
UK operations	1,079	471	1,550	1,189
	3,220	783	4,003	3,689
Balance at 1 January 2013/1 January 2012 representing:				
Asia operations	974	207	1,181	1,278
US operations	1,211	108	1,319	1,333
UK operations	772	417	1,189	810
	2,957	732	3,689	3,421

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of the revised IAS 19 and for the reclassification of the result attributable to the Japan life business – see note 18.

Notes

(i) All figures are shown post-tax.
(ii) Free surplus invested in new business represents amounts set aside for required capital and acquisition costs.
(iii) For the purposes of this analysis, free surplus for asset management operations and the UK general insurance commission is taken to be IFRS basis shareholders' equity.
(iv) Changes in non-operating items principally represent short-term fluctuations in investment returns and the effect of changes in economic assumptions for long-term business operations.
(v) Net cash flows to parent company for long-term business operations reflect the flows as included in the holding company cash flow at transaction rates.

Notes on the EEV basis results continued

8 Analysis of movement in free surplus continued

(vi) Exchange movements, timing differences and other items represent:

	2013 £m		
	Long-term business	**Asset management and UK general insurance commission**	**Total**
Exchange movements[note 12]	(164)	(28)	(192)
Mark to market value movements on Jackson assets backing surplus and required capital[note 9]	(97)	–	(97)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes[note 9]	(22)	(18)	(40)
Other[note (vii)]	96	(119)	(23)
	(187)	(165)	(352)

(vii) Other primarily reflects the effect of intra-group loans, contingent loan funding, as shown in note 12(i), timing differences and other non-cash items.

(viii) The free surplus balance at 31 December 2013 includes £392 million (2012: £177 million) representing unamortised amounts advanced to bancassurance partners for securing exclusive distribution rights. The annual amortisation charge is recorded within 'investment in new business' each year at a rate that is determined by reference to the actual sales levels achieved.

9 Reconciliation of movement in shareholders' equity

	2013 £m						2012* £m
	Long-term business operations						
	Asia operations note (i)	US operations	UK insurance operations	Total long-term business operations	Other operations note (i)	Group total	Group total
Pre-tax operating profit (based on longer-term investment returns)							
Long-term business:							
New business[note 2]	1,460	1,086	297	2,843	–	2,843	2,452
Business in force[note 3]	927	1,135	736	2,798	–	2,798	1,982
	2,387	2,221	1,033	5,641	–	5,641	4,434
Asset management	–	–	–	–	574	574	479
Other results	(2)	(1)	(16)	(19)	(616)	(635)	(600)
Pre-tax operating profit based on longer-term investment returns	2,385	2,220	1,017	5,622	(42)	5,580	4,313
Total non-operating profit	(157)	(46)	166	(37)	121	84	644
Profit before tax (including actual investment returns)	2,228	2,174	1,183	5,585	79	5,664	4,957
Tax (charge) credit attributable to shareholders' profit[note 10]:							
Tax on operating profit	(494)	(695)	(198)	(1,387)	11	(1,376)	(1,139)
Tax on non-operating profit	69	12	(34)	47	23	70	(49)
Profit for the year	1,803	1,491	951	4,245	113	4,358	3,769
Other movements (post-tax)							
Exchange movements on foreign operations and net investment hedges	(974)	(175)	–	(1,149)	72	(1,077)	(469)
Intra-group dividends (including statutory transfers)[note (ii)]	(433)	(300)	(339)	(1,072)	1,072	–	–
Investment in operations[note (iii)]	40	–	–	40	(40)	–	–
External dividends	–	–	–	–	(781)	(781)	(655)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes[note (v)]	–	–	(22)	(22)	(31)	(53)	44
Reserve movements in respect of share-based payments	–	–	–	–	98	98	42
Bancassurance agreement and purchase of Thanachart Life[notes (vi) and 4]	412	–	–	412	(412)	–	–
Other transfers	(5)	15	(20)	(10)	10	–	–
Treasury shares movements	–	–	–	–	(41)	(41)	23
New share capital subscribed	–	–	–	–	6	6	17
Mark to market value movements on Jackson assets backing surplus and required capital	–	(97)	–	(97)	–	(97)	35
Net increase in shareholders' equity	843	934	570	2,347	66	2,413	2,806
Shareholders' equity at 1 January 2013[note (i)]	9,462	6,032	6,772	22,266	177	22,443	19,637
Shareholders' equity at 31 December 2013[note (i)]	10,305	6,966	7,342	24,613	243	24,856	22,443
Representing:							
Statutory IFRS basis shareholders' equity	2,564	3,446	2,976	8,986	664	9,650	10,359
Additional retained profit (loss) on an EEV basis[note (iv)]	7,741	3,520	4,366	15,627	(421)	15,206	12,084
EEV basis shareholders' equity	10,305	6,966	7,342	24,613	243	24,856	22,443
Balance at 1 January 2013/1 January 2012							
Representing:							
Statutory IFRS basis shareholders' equity	2,290	4,343	3,008	9,641	718	10,359	8,564
Additional retained profit (loss) on an EEV basis[note (iv)]	7,172	1,689	3,764	12,625	(541)	12,084	11,073
EEV basis shareholders' equity	9,462	6,032	6,772	22,266	177	22,443	19,637

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of IFRS 11 and revised IAS 19 and for the reclassification of the result attributable to the held for sale Japan life business - see note 18.

Notes

(i) For the purposes of the table above, goodwill related to Asia long-term operations is included in other operations.

(ii) Intra-group dividends (including statutory transfers) represent dividends that have been declared in the year and amounts accrued in respect of statutory transfers. The amounts included in note 8 for these items are as per the holding company cash flow at transaction rates. The difference primarily relates to intra-group loans, timing differences arising on statutory transfers, and other non-cash items.

(iii) Investment in operations reflects increases in share capital.

Notes on the EEV basis results continued

9 Reconciliation of movement in shareholders' equity continued

(iv) The additional retained loss on an EEV basis for Other operations primarily represents the mark to market value adjustment for holding company net borrowings of a charge of £(392) million (2012: charge of £(536) million), as shown in note 7.

(v) The (charge) credit for the shareholders' share of actuarial and other gains and losses on defined benefit schemes comprises:

	2013 £m	2012* £m
IFRS basis	(48)	34
Additional shareholders' interest[note 15(c)(vi)]	(5)	10
EEV basis total	(53)	44

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of revised IAS 19 – see note 18.

(vi) The £412 million transfer from Other operations to Asia operations represents the funding of Asia operations to purchase the bancassurance agreement and Thanachart Life (as shown in note 4).

10 Tax attributable to shareholders' profit

The tax charge comprises:

	2013 £m	2012 £m
Tax charge on operating profit based on longer-term investment returns:		
Long-term business:*		
Asia operations	494	420
US operations	695	513
UK insurance operations	198	168
	1,387	1,101
Other operations†	(11)	38
Total tax charge on operating profit based on longer-term investment returns†	1,376	1,139
Tax (credit) charge on non-operating profit†	(70)	49
Tax charge on profit attributable to shareholders (including tax on actual investment returns)†	1,306	1,188

* The tax charge on operating profit for long-term business includes tax on Solvency II and restructuring costs.
† The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of IFRS 11 and revised IAS 19 – see note 18.

11 Earnings per share (EPS)

	2013 £m		2012* £m	
	Operating	Total	Operating	Total
Pre-tax profit	5,580	5,664	4,313	4,957
Tax	(1,376)	(1,306)	(1,139)	(1,188)
Post-tax profit	4,204	4,358	3,174	3,769
EPS (pence)	165.0p	171.0p	124.9p	148.3p
Average number of shares (millions)	2,548	2,548	2,541	2,541

* The 2012 comparative results have been adjusted retrospectively from those previously published for the adoption of IFRS 11, revised IAS 19 and for the reclassification of the result attributable to the held for sale Japan life business – see note 18.

12 Reconciliation of post-tax movements in net worth and value of in-force for long-term business

	2013 £m				
	Free surplus note 8	Required capital	Total net worth	Value of in-force business note (iv)	Total long-term business operations
Group					
Shareholders' equity at 1 January 2013	2,957	3,898	6,855	15,411	22,266
New business contribution notes (ii),(iii)	(637)	461	(176)	2,258	2,082
Existing business – transfer to net worth	2,017	(347)	1,670	(1,670)	–
Expected return on existing business	133	90	223	1,277	1,500
Changes in operating assumptions and experience variances*	478	(7)	471	182	653
Increase in EEV assumed level of required capital note (vi)	(58)	58	–	(13)	(13)
Loss attaching to held for sale Japan life business	(40)	–	(40)	5	(35)
Other non-operating items	(739)	(103)	(842)	900	58
Post-tax profit from long-term business	1,154	152	1,306	2,939	4,245
Exchange movements on foreign operations and net investment hedges	(164)	(117)	(281)	(868)	(1,149)
Bancassurance agreement and purchase of Thanachart Life notes 4 and (v)	365	21	386	26	412
Intra-group dividends (including statutory transfers) and investment in operations note (i)	(963)	–	(963)	(69)	(1,032)
Other movements	(129)	–	(129)	–	(129)
Shareholders' equity at 31 December 2013 note (viii)	3,220	3,954	7,174	17,439	24,613
Representing:					
Asia operations					
Shareholders' equity at 1 January 2013	974	970	1,944	7,518	9,462
New business contribution note (iii)	(310)	107	(203)	1,342	1,139
Existing business – transfer to net worth	713	29	742	(742)	–
Expected return on existing business	74	(1)	73	595	668
Changes in operating assumptions and experience variances*	32	(9)	23	61	84
Loss attaching to held for sale Japan life business note 4	(40)	–	(40)	5	(35)
Other non-operating items	(70)	(56)	(126)	73	(53)
Post-tax profit from long-term business	399	70	469	1,334	1,803
Exchange movements on foreign operations and net investment hedges	(155)	(84)	(239)	(735)	(974)
Bancassurance agreement and purchase of Thanachart Life notes 4 and (v)	365	21	386	26	412
Intra-group dividends (including statutory transfers) and investment in operations	(393)	–	(393)	–	(393)
Other movements	(5)	–	(5)	–	(5)
Shareholders' equity at 31 December 2013 note (viii)	1,185	977	2,162	8,143	10,305
US operations					
Shareholders' equity at 1 January 2013	1,211	1,600	2,811	3,221	6,032
New business contribution note (iii)	(298)	288	(10)	716	706
Existing business – transfer to net worth	796	(296)	500	(500)	–
Expected return on existing business	41	53	94	301	395
Changes in operating assumptions and experience variances*	292	21	313	111	424
Increase in EEV assumed level of required capital note (vi)	(58)	58	–	(13)	(13)
Other non-operating items	(637)	(84)	(721)	700	(21)
Post-tax profit from long-term business	136	40	176	1,315	1,491
Exchange movements on foreign operations and net investment hedges	(9)	(33)	(42)	(133)	(175)
Intra-group dividends (including statutory transfers)	(300)	–	(300)	–	(300)
Other movements	(82)	–	(82)	–	(82)
Shareholders' equity at 31 December 2013	956	1,607	2,563	4,403	6,966
UK insurance operations					
Shareholders' equity at 1 January 2013	772	1,328	2,100	4,672	6,772
New business contribution note (iii)	(29)	66	37	200	237
Existing business – transfer to net worth	508	(80)	428	(428)	–
Expected return on existing business	18	38	56	381	437
Changes in operating assumptions and experience variances*	154	(19)	135	10	145
Other non-operating items	(32)	37	5	127	132
Post-tax profit from long-term business	619	42	661	290	951
Intra-group dividends (including statutory transfers) note (i)	(270)	–	(270)	(69)	(339)
Other movements	(42)	–	(42)	–	(42)
Shareholders' equity at 31 December 2013 note (viii)	1,079	1,370	2,449	4,893	7,342

* Changes in operating assumptions and experience variances as reported above include development, Solvency II and restructuring costs.

Notes on the EEV basis results continued

12 Reconciliation of post-tax movements in net worth and value of in-force for long-term business continued

Notes

(i) The amounts shown in respect of free surplus and the value of in-force business for UK insurance operations for intra-group dividends (including statutory transfers) include contingent loan funding. Contingent loan funding represents amounts whose repayment to the lender is contingent upon future surpluses emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(ii) The movements arising from new business contribution are as follows:

	2013 £m	**2012** £m
Free surplus invested in new business	(637)	(618)
Increase in required capital	461	454
Reduction in total net worth	(176)	(164)
Increase in the value associated with new business	2,258	1,955
Total post-tax new business contribution	2,082	1,791

(iii) Free surplus invested in new business is as follows:

	2013 £m				**2012** £m			
	Asia operations	**US operations**	**UK insurance operations**	**Total long-term business operations**	**Asia operations**	**US operations**	**UK insurance operations**	**Total long-term business operations**
Pre-tax new business contribution[note 2]	1,460	1,086	297	2,843	1,266	873	313	2,452
Tax	(321)	(380)	(60)	(761)	(284)	(305)	(72)	(661)
Post-tax new business contribution	1,139	706	237	2,082	982	568	241	1,791
Free surplus invested in new business	(310)	(298)	(29)	(637)	(292)	(281)	(45)	(618)
Post-tax new business contribution per £1 million free surplus invested	3.7	2.4	8.2	3.3	3.4	2.0	5.4	2.9

(iv) The value of in-force business includes the value of future margins from current in-force business less the cost of holding required capital and represents:

	2013 £m				**2012** £m			
	Asia operations	**US operations**	**UK insurance operations**	**Total long-term business operations**	**Asia operations**	**US operations**	**UK insurance operations**	**Total long-term business operations**
Value of in-force business before deduction of cost of capital and time value of guarantees	8,540	4,769	5,135	18,444	7,903	3,992	4,916	16,811
Cost of capital	(347)	(220)	(242)	(809)	(352)	(121)	(244)	(717)
Cost of time value of guarantees[note (vii)]	(50)	(146)	–	(196)	(33)	(650)	–	(683)
Net value of in-force business	8,143	4,403	4,893	17,439	7,518	3,221	4,672	15,411

(v) The free surplus increase of £365 million in respect of the transaction with Thanachart Bank includes the purchase cost of the partnership agreement to enable future new sales through the bancassurance channel. As new business is written, the carrying value of this purchase cost is amortised against the new business contribution line of this reconciliation.

(vi) The increase in required capital in US operations of £58 million reflects the effect of the change from 235 per cent to 250 per cent of risk-based capital.

(vii) The decrease in the cost of time value of guarantees for US operations from £(650) million at 2012 to £(146) million at 2013 primarily relates to variable annuity business, mainly arising from the increase in the expected long-term separate account rate of return of 1.3 per cent driven by the increase in the US 10-year treasury bond rate and strong equity performance, partly offset by the impact from new business written in the year.

(viii) Effects of domestication of Hong Kong branch in 2014

The analysis of shareholders' equity at 31 December 2013 does not incorporate the impact of the domestication of the Hong Kong branch which took effect on 1 January 2014. In order to align the corporate structure of the branch business in Hong Kong more closely with Prudential's other Asia operations, the Board of PAC initiated a proposal to transfer the branch business to two Hong Kong-incorporated companies – Prudential Hong Kong Limited and Prudential General Insurance Hong Kong Limited – with one providing life insurance and the other providing general insurance.

Following consultation with policyholders of PAC and court approval, the assets and liabilities of the Hong Kong branch business of PAC transferred to separate subsidiaries on 1 January 2014. As a consequence of this restructuring, adjustments in respect of required capital, and the cost of that capital, will be necessary. This arises from the transfer of capital that was previously held within the UK business in respect of the Hong Kong branch operations and additional capital requirements that arise from the newly established subsidiaries. These will be reflected in the movements in net worth and value of in-force business reported in 2014 as adjustments to opening balances as follows:

	£m				
Adjustment to shareholders' equity at 1 January 2014	**Free surplus**	**Required capital**	**Total net worth**	**Value of in-force business**	**Total long-term business operations**
Asia operations	(104)	104	–	(40)	(40)
UK insurance operations	69	(69)	–	29	29
Net impact on Group total	(35)	35	–	(11)	(11)

The adjustments for UK insurance operations reflect the transfer of required capital, and attaching cost of capital, for amounts previously set aside whilst the Hong Kong business was a branch of Prudential Assurance Company, to the Asia operations segment. The adjustments for Asia operations reflect this transfer and the effects of additional capital requirements of the Hong Kong regulator under the arrangements for the newly domesticated business. The net effect reflects the higher required capital levels attributable to the stand-alone Hong Kong shareholder-backed long-term insurance business.

13 Expected transfer of value of in-force business to free surplus

The discounted value of in-force business and required capital can be reconciled to the 2013 and 2012 totals in the tables below for the emergence of free surplus as follows:

	2013 £m	2012 £m
Required capital[note12]	3,954	3,898
Value of in-force (VIF)[note12]	17,439	15,411
Add back: deduction for cost of time value of guarantees[note12]	196	683
Expected cash flow from sale of Japan life business	(25)	–
Other items[note]	(1,157)	(1,401)
Total	20,407	18,591

Note
'Other items' represent amounts incorporated into VIF where there is no definitive timeframe for when the payments will be made or receipts received. In particular, other items includes the deduction of the value of the shareholders' interest in the estate, the value of which is derived by increasing final bonus rates so as to exhaust the estate over the lifetime of the in-force with-profits business. This is an assumption to give an appropriate valuation. To be conservative, this item is excluded from the expected free surplus generation profile below.

Cash flows are projected on a deterministic basis and are discounted at the appropriate risk discount rate. The modelled cash flows use the same methodology underpinning the Group's embedded value reporting and so are subject to the same assumptions and sensitivities.

The table below shows how the VIF generated by the in-force business and the associated required capital is modelled as emerging into free surplus over future years.

	2013 £m						
		Expected period of conversion of future post-tax distributable earnings and required capital flows to free surplus					
	2013 total as shown above	1-5 years	6-10 years	11-15 years	16-20 years	21-40 years	40+ years
Asia operations*	9,021	3,168	1,883	1,275	855	1,465	375
US operations	6,234	3,326	1,845	653	271	139	–
UK insurance operations	5,152	1,915	1,326	870	536	487	18
Total	20,407	8,409	5,054	2,798	1,662	2,091	393
	100%	41%	25%	14%	8%	10%	2%

* Following its reclassification as held for sale, the Asia cash flows exclude any cash flows in respect of Japan.

	2012 £m						
		Expected period of conversion of future post tax distributable earnings and required capital flows to free surplus					
	2012 total as shown above	1-5 years	6-10 years	11-15 years	16-20 years	21-40 years	40+ years
Asia operations	8,410	2,987	1,873	1,181	840	1,297	232
US operations	5,439	2,723	1,607	698	301	110	–
UK insurance operations	4,742	1,890	1,185	756	456	445	10
Total	18,591	7,600	4,665	2,635	1,597	1,852	242
	100%	41%	25%	14%	9%	10%	1%

Notes on the EEV basis results continued

14 Sensitivity of results to alternative assumptions

(a) Sensitivity analysis - economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2013 (31 December 2012) and the pre-tax new business contribution after the effect of required capital for 2013 and 2012 to:

— 1 per cent increase in the discount rates;
— 1 per cent increase and decrease in interest rates, including all consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets, risk discount rates);
— 1 per cent rise in equity and property yields;
— 10 per cent fall in market value of equity and property assets (embedded value only);
— The statutory minimum capital level (by contrast to EEV basis required capital), (for embedded value only);
— 5 basis point increase in UK long-term expected defaults; and
— 10 basis point increase in the liquidity premium for UK annuities.

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions.

New business contribution

	2013 £m				2012 £m			
	Asia operations	US operations	UK insurance operations	Total long-term business operations	Asia operations	US operations	UK insurance operations	Total long-term business operations
Pre-tax new business contribution note 2	1,460	1,086	297	2,843	1,266	873	313	2,452
Discount rates – 1% increase	(187)	(52)	(36)	(275)	(163)	(40)	(38)	(241)
Interest rates – 1% increase	23	72	(1)	94	33	104	6	143
Interest rates – 1% decrease	(61)	(107)	–	(168)	(106)	(161)	(11)	(278)
Equity/property yields – 1% rise	56	96	13	165	48	97	13	158
Long-term expected defaults – 5 bps increase	–	–	(8)	(8)	–	–	(10)	(10)
Liquidity premium – 10 bps increase	–	–	16	16	–	–	20	20

Embedded value of long-term business operations

	2013 £m				2012 £m			
	Asia operations	US operations	UK insurance operations	Total long-term business operations	Asia operations	US operations	UK insurance operations	Total long-term business operations
Shareholders' equity note 9	10,305	6,966	7,342	24,613	9,462	6,032	6,772	22,266
Discount rates – 1% increase	(992)	(266)	(529)	(1,787)	(879)	(209)	(482)	(1,570)
Interest rates – 1% increase	(297)	(65)	(380)	(742)	(218)	(124)	(328)	(670)
Interest rates – 1% decrease	200	(12)	443	631	85	49	399	533
Equity/property yields – 1% rise	370	250	210	830	328	230	202	760
Equity/property market values – 10% increase	(183)	(90)	(238)	(511)	(159)	(69)	(309)	(537)
Statutory minimum capital	109	153	4	266	108	89	4	201
Long-term expected defaults – 5 bps increase	–	–	(114)	(114)	–	–	(112)	(112)
Liquidity premium – 10 bps increase	–	–	228	228	–	–	224	224

The sensitivities shown above are for the impact of instantaneous changes on the embedded value of long-term business operations and include the combined effect on the value of in-force business and net assets at the balance sheet dates indicated. If the change in assumption shown in the sensitivities were to occur, then the effect shown above would be recorded within two components of the profit analysis for the following year. These are for the effect of economic assumption changes and, to the extent that asset value changes are included in the sensitivities, within short-term fluctuations in investment returns. In addition to the sensitivity effects shown above, the other components of the profit for the following year would be calculated by reference to the altered assumptions, for example new business contribution and unwind of discount, together with the effect of other changes such as altered corporate bond spreads.
In addition for Jackson, the fair value movements on assets backing surplus and required capital which are taken directly to shareholders' equity would also be affected by changes in interest rates.

(b) Sensitivity analysis – non-economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2013 and 31 December 2012 and the pre-tax new business contribution after the effect of required capital for 2013 and 2012 to:

- 10 per cent proportionate decrease in maintenance expenses (a 10 per cent sensitivity on a base assumption of £10 per annum would represent an expense assumption of £9 per annum);
- 10 per cent proportionate decrease in lapse rates (a 10 per cent sensitivity on a base assumption of 5 per cent would represent a lapse rate of 4.5 per cent per annum); and
- 5 per cent proportionate decrease in base mortality and morbidity rates (ie increased longevity).

New business contribution

	2013 £m				2012 £m			
	Asia operations	US operations	UK insurance operations	Total long-term business operations	Asia operations	US operations	UK insurance operations	Total long-term business operations
Pre-tax new business contribution note 2	1,460	1,086	297	2,843	1,266	873	313	2,452
Maintenance expenses – 10% decrease	29	12	4	45	32	13	4	49
Lapse rates – 10% decrease	109	41	8	158	95	26	7	128
Mortality and morbidity – 5% decrease	75	6	(8)	73	76	5	(11)	70
Change representing effect on:								
Life business	75	6	3	84	76	5	3	84
UK annuities	–	–	(11)	(11)	–	–	(14)	(14)

Embedded value of long-term business operations

	2013 £m				2012 £m			
	Asia operations	US operations	UK insurance operations	Total long-term business operations	Asia operations	US operations	UK insurance operations	Total long-term business operations
Shareholders' equity note 9	10,305	6,966	7,342	24,613	9,462	6,032	6,772	22,266
Maintenance expenses – 10% decrease	126	59	58	243	137	50	56	243
Lapse rates – 10% decrease	352	294	79	725	333	225	66	624
Mortality and morbidity – 5% decrease	377	154	(254)	277	387	178	(273)	292
Change representing effect on:								
Life business	377	154	20	551	387	178	13	578
UK annuities	–	–	(274)	(274)	–	–	(286)	(286)

Notes on the EEV basis results continued

15 Methodology and accounting presentation

(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 results for covered business, including the Group's investments in joint venture insurance operations, are presented on a pre-tax basis, with tax reported separately. The EEV basis results for the Group's covered business are then combined with the IFRS basis results of the Group's other operations. Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management.

The definition of long-term business operations is consistent with previous practice and comprises those contracts falling under the definition 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.

Covered business comprises the Group's long-term business operations, with two exceptions:

— The closed Scottish Amicable Insurance Fund (SAIF) which is excluded from covered business. 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 presentational treatment of the Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS). The partial recognition of the surplus for PSPS is recognised in 'Other' operations, as described in note 15(c)(vi).

A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

(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 15(c)(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 15(c)(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.

Demographic assumptions

Persistency, mortality and morbidity assumptions are based on an analysis of recent experience but also reflect expected future experience. Where relevant, when calculating the time value of financial options and guarantees, policyholder withdrawal rates vary in line with the emerging investment conditions according to management's expectations.

Expense assumptions

Expense levels, including those of service companies that support the Group's long-term business operations, are based on internal expense analysis investigations and are appropriately allocated to acquisition of new business and renewal of in-force business. Exceptional expenses are identified and reported separately. For mature business, it is Prudential's policy not to take credit for future cost reduction programmes until the savings have been delivered. For businesses which are currently sub-scale (China, Malaysia Takaful and Taiwan) and India (where the business model is being adapted in response to the regulatory changes introduced in recent years), expense overruns are permitted where these are expected to be short-lived.

For Asia operations, the expenses comprise costs borne directly and recharged costs from the Asia regional head office, that are attributable to covered business. The assumed future expenses for these operations also include projections of these future recharges. Development expenses are charged as incurred.

Corporate expenditure comprises:

- Expenditure for Group head office, to the extent not allocated to the PAC with-profits funds, together with Solvency II implementation and restructuring costs, which are charged to the EEV basis results as incurred; and
- Expenditure of the Asia regional head office that is not allocated to the covered business or asset management operations which is charged as incurred. These costs are primarily for corporate related activities and are included within corporate expenditure.

Principal economic assumptions

The EEV basis results for the Group's operations 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 year end rates of return on government bonds.

Expected returns on equity and property asset classes and corporate bonds are derived by adding a risk premium, based on the Group's long-term view, 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 year.

New business

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

New business premiums reflect those premiums attaching to covered business, including premiums for contracts classified as investment products for IFRS basis reporting. New business premiums for regular premium products are shown on an annualised basis. Internal vesting business is classified as new business where the contracts include an open market option.

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

For UK immediate annuity business and single premium Universal Life products in Asia, primarily Singapore, the new business contribution is determined by applying economic assumptions reflecting point of sale market conditions. This is consistent with how the business is priced as crediting rates are linked to yields on specific assets and the yield is locked-in when the assets are purchased at the point-of-sale of the policy. For other business within the Group, end of period economic assumptions are used.

New business profitability is a key metric for the Group's management of the development of the business. In addition, new business margins are shown by reference to annual premium equivalents (APE) and the present value of new business premiums (PVNBP). These margins are calculated as the percentage of the value of new business profit to APE and PVNBP. APE is calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. PVNBP is 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.

Valuation movements on investments

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

The results for any covered business conceptually reflect 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 broadly speaking, are 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 (post- 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.

Notes on the EEV basis results continued

15 Methodology and accounting presentation continued

Financial options and guarantees

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

Asia 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.

US operations (Jackson)

The principal financial 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 for 2013 and 2012, depending on the particular product, jurisdiction where issued, and date of issue. For 2013 and 2012, 86 per cent of the account values on fixed annuities are for policies with guarantees of 3 per cent or less. The average guarantee rate is 2.8 per cent for 2013 and 2012.

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)). These guarantees generally protect the policyholder's value in the event of poor equity market performance. Jackson hedges the GMDB and GMWB guarantees through the use of equity options and futures contracts, and fully reinsures the GMIB guarantees.

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

For covered business the only significant financial options and guarantees in the UK insurance operations arise in the with-profits fund.

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 also held a provision on the Pillar I Peak 2 basis of £36 million at 31 December 2013 (31 December 2012: £47 million) to honour guarantees on a small number of guaranteed annuity option products.

The only material guaranteed surrender values relate to investments in the PruFund range of with-profits funds. For these products the policyholder can choose to pay an additional management charge. In return, at the selected guarantee date, the fund will be increased if necessary to a guaranteed minimum value (based on the initial investment adjusted for any prior withdrawals). The with-profits fund held a reserve of £36 million at 31 December 2013 (31 December 2012: £52 million) in respect of this guarantee.

The Group's main exposure to guaranteed annuity options in the UK is through the non-covered business of SAIF. A provision on the Pillar I Peak 2 basis of £328 million was held in SAIF at 31 December 2013 (31 December 2012: £371 million) to honour the guarantees. As described in note 15(a) above, the assets and liabilities are wholly attributable to the policyholders of the fund. Therefore 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 notes 16(iv),(v) and (vi).

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 which explains how regular and final bonus rates within the discretionary framework are determined, subject to the general legislative requirements applicable.

(ii) Level of required capital

In adopting the EEV Principles, Prudential has based required capital on its internal targets subject to it being at least the local statutory minimum requirements. 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:

- Asia operations: the level of required capital has been set to an amount at least equal to the higher of local statutory requirements and the internal target;
- US operations: the level of required capital has been set at 250 per cent (2012: 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 to an amount at least equal to the higher of Pillar I and Pillar II requirements for shareholder-backed business of UK insurance operations as a whole.

(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 by reference 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.

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 reflect 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 total credit risk is to cover:

- Expected long-term defaults;
- Credit risk premium (to reflect the volatility in downgrade and 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.

Asia operations

For Asia 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.

The projected rates of return for holdings of corporate bonds comprise the risk-free rate plus an assessment of long-term spread over the risk-free rate.

Notes on the EEV basis results continued

15 Methodology and accounting presentation continued

US operations (Jackson)

For Jackson business, the allowance for long-term defaults is reflected in the risk margin reserve (RMR) 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 downgrades and defaults as shown in note 16(ii). In determining this allowance a number of factors have been considered. These factors, in particular, include:

— How much of the credit spread on debt securities represents an increased credit risk not reflected in the RMR long-term default assumptions, and how much is liquidity premium (which is the premium required by investors to compensate for the risk of longer-term investments which cannot be easily converted into cash, and converted at the fair market value). In assessing this effect, consideration has been given to a number of approaches to estimating the liquidity premium by considering recent statistical data; and

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

The level of the additional allowance is assessed at each reporting period to take account of prevailing credit conditions and as the business in force alters over time. The additional allowance for variable annuity business has been set at one-fifth of the non-variable annuity business to reflect the proportion of the allocated holdings of general account debt securities.

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 operations

(1) 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 as the assets are generally held to maturity to match long duration liabilities, 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 derived as a percentage of historical default experience based on Moody's data for the period 1970 to 2009 and the definition of the credit rating assigned to each asset held is the second highest credit rating published by Moody's, Standard & Poor's and Fitch;

— A credit risk premium, which is derived as the excess over the expected long-term defaults, of the 95th percentile of historical cumulative defaults based on Moody's data for the period 1970 to 2009, and subject to a minimum margin over expected long-term defaults of 50 per cent;

— An allowance for a 1 notch downgrade of the asset portfolio subject to credit risk; and

— An allowance for 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, 1 notch downgrade and the remaining element of short-term downgrade and default allowances are incorporated into the risk margin included in the discount rate, as shown in note 16(iii)(b).

(2) With-profits fund non-profit annuity business

For UK non-profit annuity business including that written by Prudential Annuities Limited (PAL) the basis for determining the aggregate allowance for credit risk is consistent with that applied for UK shareholder-backed annuity business (as described above). 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.

(3) With-profits 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

The majority of non-market and non-credit risks are considered to be diversifiable. 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 other than shareholder-backed annuity, no additional allowance is necessary. For UK shareholder-backed annuity business a further allowance of 50 basis points is used to reflect the longevity risk which is of particular relevance. For the Group's Asia operations in China, India, Indonesia, the Philippines, Taiwan, Thailand and Vietnam, additional allowances are applied for emerging market risk ranging from 100 to 250 basis points.

(iv) 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 any 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-profits funds of the Group's Asia operations.

(v) 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.

(vi) Foreign currency translation

Foreign currency profits and losses have been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year end rates of exchange. The principal exchange rates are shown in note A1 of the IFRS statements.

(c) Accounting presentation

(i) Analysis of profit before tax

To the extent applicable, the presentation of the EEV profit for the year 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 (which are determined as described in note 15(c)(ii) below) and incorporate the following:

— New business contribution, as defined in note 15(b)(i);
— Unwind of discount on the value of in-force business and other expected returns, as described in note 15(c)(iv) below;
— The impact of routine changes of estimates relating to non-economic assumptions, as described in note 15(c)(iii) below; and
— Non-economic experience variances, as described in note 15(c)(v) below.

Non-operating results comprise the recurrent items of short-term fluctuations in investment returns, the mark to market value movements on core borrowings and the effect of changes in economic assumptions.

In addition, the 2013 operating profit excludes the loss attaching to the held for sale Japan life business and the costs associated with the domestication of the Hong Kong branch. The 2012 operating profit excluded the gain arising on the acquisition of REALIC, the profit attaching to the Japan life business and the dilution of the Group's holding in PPM South Africa. 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.

Post-tax results

The Group intends to alter its basis of presentation of EEV results for 2014 and subsequent reporting periods to a post-tax basis, in line with the approach adopted by a number of international insurance groups. An analysis of the Group's profit and loss account and key accompanying notes on a pre-tax and post-tax basis for the most recent reporting periods are shown in the additional unaudited financial information section in note III(c).

(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 15(c)(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 year 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 year projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with the related hedging activity.

Notes on the EEV basis results continued

15 Methodology and accounting presentation continued

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 included in the result for the year.

(iii) Effect of changes in operating assumptions

Operating profit includes 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 at the beginning of the period (adjusted for the effect of current period economic and operating assumption changes); and
- Required capital and surplus assets.

In applying this general approach, the unwind of discount included in operating profit for the with-profits business of UK insurance operations is determined by reference to the opening value of in-force, as adjusted for the effects of short-term investment volatility due to market movements (ie smoothed). In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed. At 31 December 2013 the shareholders' interest in the smoothed surplus assets used for this purpose only were £136 million lower (31 December 2012: £121 million lower) than the surplus assets carried in the statement of financial position.

(v) Operating experience variances

Operating profits include the effect of experience variances on non-economic assumptions, which are calculated with reference to the embedded value assumptions at the end of the reporting year, such as persistency, mortality and morbidity, expenses and other factors.

(vi) 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 year are recorded within Other Comprehensive Income. Consistent with the basis of distribution of bonuses and the treatment of the estate described in notes 15(b)(i) and (iv), 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 as booked for IFRS reporting.

(vii) 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.

(viii) Taxation

The profit for the year for covered business is in most cases calculated initially at the post-tax level. For 2013 and 2012 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. The overall tax rate includes the impact of tax effects determined on a local regulatory basis. 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. Current taxation and other legislation have been assumed to continue unaltered except where changes have been announced and substantively enacted in the year. Additional detail of pre and post-tax EEV basis results are shown in the additional financial information.

(ix) Inter-company arrangements

The EEV results for covered business incorporate annuities established in the PAC non-profit sub-fund from vesting pension polices in SAIF (which is not covered business). The EEV results also incorporate the effect of the reinsurance arrangement of non-profit immediate pension annuity liabilities of SAIF to PRIL. In addition, the free surplus and value of in-force business are calculated after taking account of the impact of contingent loan arrangements between Group companies (movements in the contingent loan liability are reflected via the projected cash flows in the value of in-force and the related funding is reflected in free surplus).

16 Assumptions

Deterministic assumptions

The tables below summarise the principal financial assumptions:

Assumed investment returns reflect the expected future returns on the assets held and allocated to the covered business at the valuation date.

(i) Asia operations notes (b), (d)

	Risk discount rate %				Expected long-term inflation %		10-year government bond yield %	
	New business		In force					
	31 Dec		31 Dec		31 Dec		31 Dec	
	2013	2012	2013	2012	2013	2012	2013	2012
China	11.2	10.1	11.2	10.1	2.5	2.5	4.7	3.6
Hong Kong notes (b), (c)	4.9	3.8	4.8	3.5	2.3	2.3	3.1	1.8
India	14.0	13.2	14.0	13.2	4.0	4.0	9.0	8.2
Indonesia	12.5	9.4	12.5	9.4	5.0	5.0	8.6	5.3
Korea	7.4	7.4	7.6	7.2	3.0	3.0	3.6	3.2
Malaysia note (c)	6.5	5.8	6.5	5.8	2.5	2.5	4.2	3.5
Philippines	10.5	11.1	10.5	11.1	4.0	4.0	3.8	4.4
Singapore note (c)	4.6	3.6	5.3	4.3	2.0	2.0	2.6	1.3
Taiwan	4.3	3.3	4.1	3.4	1.0	1.0	1.7	1.2
Thailand	10.7	10.3	10.7	10.3	3.0	3.0	3.9	3.5
Vietnam	15.7	17.2	15.7	17.2	5.5	5.5	9.0	10.5
Total weighted risk discount rate note (a)	8.1	6.8	7.2	6.1				

Notes

(a) The weighted risk discount rates for Asia operations shown above have been determined by weighting each country's risk discount rates by reference to the pre-tax EEV basis new business result and the closing value of in-force business. The changes in the risk discount rates for individual Asia territories reflect the movements in government bond yields, together with the effects of movements in the allowance for market risk and changes in product mix.

(b) For Hong Kong, the assumptions shown are for US dollar denominated business. For other territories, the assumptions are for local currency denominated business.

(c) The mean equity return assumptions for the most significant equity holdings in the Asia operations were:

	31 Dec 2013 %	31 Dec 2012 %
Hong Kong	7.1	5.8
Malaysia	10.1	9.5
Singapore	8.6	7.4

(d) Equity risk premiums in Asia (excluding those for the held for sale Japan life business) range from 3.5 per cent to 8.7 per cent for 2013 (2012: 3.5 per cent to 8.8 per cent).

Notes on the EEV basis results continued

16 Assumptions continued

(ii) US operations

	31 Dec 2013 %	31 Dec 2012 %
Assumed new business spread margins:note (a)		
Fixed Annuity business:*		
January to June issues	1.2	1.4
July to December issues	1.75	1.1
Fixed Index Annuity business:		
January to June issues	1.45	1.75
July to December issues	2.00	1.35
Institutional business	0.75	1.25
Allowance for long-term defaults included in projected spreadnote (b)	0.25	0.28
Risk discount rate:		
Variable annuity:		
Risk discount rate	7.6	6.5
Additional allowance for credit risk included in risk discount ratenote (b)	0.2	0.3
Non-variable annuity:		
Risk discount rate	4.8	4.0
Additional allowance for credit risk included in risk discount ratenote (b)	1.0	1.5
Weighted average total:note (c)		
New business	7.4	6.3
In force	6.9	5.6
US 10-year treasury bond rate at end of year	3.1	1.8
Pre-tax expected long-term nominal rate of return for US equities	7.1	5.8
Expected long-term rate of inflation	2.6	2.5
Equity risk premium	4.0	4.0
Assumed tax rate for value of in-force business	35.0	35.0

* Including the proportion of variable annuity business invested in the general account.

Notes

(a) The assumed new business spread margins represent the difference between the earned rate on investments, after allowance for long-term defaults, and the policy holder crediting rate. The spread margins shown above are the rates at inception. For fixed annuity business (including the proportion of variable annuity business invested in the general account) and fixed index annuity business, the assumed spread margin grades up linearly by 25 basis points to a long-term assumption over five years.

(b) The allowance for long-term defaults included in projected spread is shown as at the valuation date applied in the cash flow projections of the value of the in-force business. The risk discount rates include an additional allowance for credit risk premium and short-term downgrades and defaults. See note 15(b)(iii) for further details.

(c) The weighted average risk discount rates reflect the mix of business between variable annuity and non-variable annuity business. The increase in the weighted average risk discount rates from 2012 to 2013 primarily reflects the increase in the US 10-year Treasury bond rate of 130 basis points, partly offset by the effect of the decrease in additional allowance for credit risk.

(iii) UK insurance operations

	31 Dec 2013 %	31 Dec 2012 %
Shareholder-backed annuity business:[note (b)]		
Risk discount rate:		
New business	6.8	6.9
In force[note (a)]	8.3	8.0
Pre-tax expected long-term nominal rate of return for shareholder-backed annuity business:		
New business	4.2	4.2
In force[note (a)]	4.3	3.9
Other business:		
Risk discount rate:		
New business	6.1	5.2
In force	6.8	5.6
Pre-tax expected long-term nominal rates of investment return:		
UK equities	7.5	6.3
Overseas equities	7.1 to 9.2	5.8 to 9.6
Property	6.2	5.1
15-year gilt rate	3.5	2.3
Corporate bonds	5.1	3.9
Post-tax expected long-term nominal rate of return for the PAC with-profits fund:		
Pension business (where no tax applies)	6.2	5.0
Life business	5.4	4.4
Expected long-term rate of inflation	3.4	2.9
Equity risk premium	4.0	4.0
Assumed tax rate for value of in-force business[note 3(iv)(b)]	20.0	23.0

Notes

(a) For shareholder-backed annuity business, the movements in the pre-tax long-term nominal rates of return and the risk discount rates for in-force business mainly reflect the effect of changes in asset yields.

(b) Credit spread treatment
For Prudential Retirement Income Limited, which has approximately 90 per cent of UK shareholder-backed annuity business the credit assumptions used in the underlying MCEV calculation (see note 15(b)(iii)) and the residual liquidity premium element of the bond spread over swap rates is as follows:

	New business* (bps)		In-force business (bps)	
	31 Dec 2013	31 Dec 2012	31 Dec 2013	31 Dec 2012
Bond spread over swap rates	127	150	133	161
Total credit risk allowance	36	35	62	65
Liquidity premium	91	115	71	96

* The new business liquidity premium is based on the weighted average of the point of sale liquidity premia.

The overall allowance for credit risk is prudent by comparison with historic rates of default and would be sufficient to withstand a wide range of extreme credit events over the expected lifetime of the annuity business.

Notes on the EEV basis results continued

16 Assumptions continued

Stochastic assumptions

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations described above. Assumptions specific to the stochastic calculations, such as the volatilities of asset returns, reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of longer-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 allowance for correlation between the various asset classes.

Details are given below of the key characteristics and calibrations of each model.

(iv) Asia operations

— The same asset return models as described for UK insurance operations below, appropriately calibrated, have been used for Asia operations. The principal asset classes are government and corporate bonds. Equity holdings are much lower than in the UK whilst property holdings do not represent a significant investment asset;
— The stochastic cost of guarantees is primarily only of significance for the Hong Kong, Korea, Malaysia, Singapore and Taiwan operations; and
— The mean stochastic returns are consistent with the mean deterministic returns for each country. The expected volatility of equity returns ranges from 18 per cent to 35 per cent in both years, and the volatility of government bond yields ranges from 0.9 per cent to 2.3 per cent in both years.

(v) US operations (Jackson)

— Interest rates are projected using a log-normal generator calibrated to historical US Treasury yield curves;
— Corporate bond returns are based on Treasury securities plus a spread that has been calibrated to current market conditions and varies by credit quality; and
— Variable annuity equity returns and bond interest rates have been stochastically generated using a log-normal model with parameters determined by reference to historical data. The volatility of equity fund returns ranges from 19 per cent to 32 per cent for both 2013 and 2012, depending on the risk class and the class of equity, and the standard deviation of interest rates ranges from 2.2 per cent to 2.5 per cent for both years.

(vi) UK insurance operations

— Interest rates are projected using a two-factor model calibrated to the initial market yield curve;
— The risk premium on equity assets is assumed to follow a log-normal distribution;
— The corporate bond return is calculated as the return on a zero-coupon bond plus a spread. The spread process is a mean reverting stochastic process; and
— Property returns are modelled in a similar fashion to corporate bonds, namely as the return on a risk-free bond, plus a risk premium, plus a process representative of the change in residual values and the change in value of the call option on rents.

Mean returns have been derived as the annualised arithmetic average return across all simulations and durations.

For each projection year, standard deviations have been calculated by taking the square root of the annualised variance of the returns over all the simulations. These have been averaged over all durations in the projection. For equity and property, the standard deviations relate to the total return on these assets. The standard deviations applied for both years are as follows:

	%
Equities:	
UK	20
Overseas	18
Property	15

17 New business premiums and contributions note (i)

	Single		Regular		Annual premium and contribution equivalents (APE) note 15(b)(i)		Present value of new business premiums (PVNBP) note 15(b)(i)	
	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m	2013 £m	2012 £m
Group insurance operations								
Asia	2,136	1,568	1,911	1,740	2,125	1,897	11,375	10,544
US	15,712	14,504	2	12	1,573	1,462	15,723	14,600
UK	5,128	6,286	212	207	725	836	5,978	7,311
Group total	22,976	22,358	2,125	1,959	4,423	4,195	33,076	32,455
Asia insurance operations								
Cambodia	–	–	1	–	1	–	3	–
Hong Kong	326	157	455	380	487	396	2,795	2,316
Indonesia	303	359	445	410	477	446	1,943	2,097
Malaysia	114	98	197	208	208	218	1,352	1,388
Philippines	193	172	34	28	53	45	299	254
Singapore	571	399	304	261	361	301	2,588	2,314
Thailand	66	12	61	36	68	37	289	140
Vietnam	2	1	54	44	54	45	204	159
SE Asia operations including Hong Kong	1,575	1,198	1,551	1,367	1,709	1,488	9,473	8,668
China note (ii)	114	37	71	53	83	56	409	277
Korea	311	94	82	86	113	95	641	438
Taiwan	102	172	107	138	117	156	491	723
India note (iii)	34	67	100	96	103	102	361	438
Total Asia operations	2,136	1,568	1,911	1,740	2,125	1,897	11,375	10,544
US insurance operations								
Variable annuities	10,795	11,596	–	–	1,079	1,160	10,795	11,596
Elite Access (variable annuity)	2,585	849	–	–	259	85	2,585	849
Fixed annuities	555	581	–	–	55	58	555	581
Fixed index annuities	907	1,094	–	–	91	109	907	1,094
Life	1	6	2	12	2	12	12	102
Wholesale	869	378	–	–	87	38	869	378
Total US insurance operations	15,712	14,504	2	12	1,573	1,462	15,723	14,600
UK and Europe insurance operations								
Direct and partnership annuities	284	297	–	–	28	30	284	297
Intermediated annuities	488	653	–	–	49	65	488	653
Internal vesting annuities	1,305	1,456	–	–	131	146	1,305	1,456
Total individual annuities	2,077	2,406	–	–	208	241	2,077	2,406
Corporate pensions	120	303	161	159	173	189	686	1,045
Onshore bonds	1,754	2,275	–	–	176	228	1,756	2,277
Other products	901	894	51	48	140	137	1,183	1,175
Wholesale	276	408	–	–	28	41	276	408
Total UK and Europe insurance operations	5,128	6,286	212	207	725	836	5,978	7,311
Group total	22,976	22,358	2,125	1,959	4,423	4,195	33,076	32,455

Notes

(i) The tables 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. The amounts shown are not, and not intended to be, reflective of premium income recorded in the IFRS income statement.

(ii) New business in China is included at Prudential's 50 per cent interest in the China Life operation.

(iii) New business in India is included at Prudential's 26 per cent interest in the India Life operation.

Notes on the EEV basis results continued

18 Additional information on the effect of the agreement to sell Japan life business and adoption of new and amended IFRS accounting standards

In July 2013 the Group agreed to sell, dependent on regulatory approval, its life insurance business in Japan which we closed to new business in 2010. Also, in 2013 the Group has adopted new accounting standards on 'Joint arrangements' (IFRS 11) and amendments to 'Employee benefits' (IAS 19), from 1 January 2013. Accordingly, the 2012 comparative EEV basis results have been retrospectively adjusted from those previously published for the application of the IFRS standards and for the reclassification of the result attributable to the held for sale Japan life business. The tables below show the results on the previous and revised basis of reporting.

	2013 £m			
		Effect of change		
	Under previous basis note (i)	**IFRS 11** note (ii)	**IAS 19** note (iii)	**Under new policies**
Pre-tax operating profit based on longer-term investment returns				
Asia operations				
Long-term business:				
Before reclassification of held for sale Japan life business	2,394	–	–	2,394
Reclassification of Japan life business	(7)	–	–	(7)
	2,387	–	–	2,387
Eastspring investments	82	(8)	–	74
Other results	3,119	–	–	3,119
Pre-tax operating profit based on longer-term investment returns	5,588	(8)	–	5,580
Short-term fluctuations in investment returns:				
Before reclassification of held for sale Japan life business	(790)	–	(1)	(791)
Reclassification of Japan life business	(28)	–	–	(28)
	(818)	–	(1)	(819)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	(69)	–	69	–
Effect of changes in economic assumptions:				
Before reclassification of held for sale Japan life business	818	–	–	818
Reclassification of Japan life business	3	–	–	3
	821	–	–	821
Loss attaching to held for sale Japan life business:				
Reclassification from pre-tax operating profit based on longer-term investment returns	7	–	–	7
Reclassification from short-term fluctuations in investment returns	28	–	–	28
Reclassification from effect of changes in economic assumptions	(3)	–	–	(3)
Remeasurement of carrying value of Japan life business classified as held for sale	(67)	–	–	(67)
	(35)	–	–	(35)
Mark to market value movements on core borrowings	152	–	–	152
Costs of domestication of Hong Kong branch	(35)	–	–	(35)
Profit before tax	5,604	(8)	68	5,664
Tax attributable to shareholders' profit	(1,299)	8	(15)	(1,306)
Profit for the year attributable to shareholders	4,305	–	53	4,358
Items taken directly to shareholders' equity	(1,892)	–	(53)	(1,945)
Net increase in shareholders' equity	2,413	–	–	2,413
Total EPS based on post-tax profit (in pence)	169.0p	–	2.0p	171.0p

Summary statement of financial position

	31 Dec 2013 £m			
	Under previous basis note (i)	Effect of change IFRS 11 note (ii)	Effect of change IAS 19	Under new policies
Total net assets				
Total assets less liabilities, before deduction for insurance funds:				
Before reclassification of held for sale Japan life business	292,791	(3,151)	–	289,640
Reclassification of Japan life business	(814)	–	–	(814)
	291,977	(3,151)	–	288,826
Less insurance funds:				
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds:				
Before reclassification of held for sale Japan life business	(283,141)	3,151	–	(279,990)
Reclassification of Japan life business	814	–	–	814
	(282,327)	3,151	–	(279,176)
Less shareholders' accrued interest in the long-term business	15,206	–		15,206
Total net assets	24,856	–	–	24,856

	2012 £m			
	As reported under previous basis note (i)	Effect of change IFRS 11 note (ii)	Effect of change IAS 19 note (iii)	Under new policies
Pre-tax operating profit based on longer-term investment returns				
Asia operations				
Long-term business:				
Before reclassification of held for sale Japan life business	1,960	–	–	1,960
Reclassification of Japan life business	(2)	–	–	(2)
	1,958	–	–	1,958
Eastspring investments	75	(6)	–	69
Other results	2,286	–	–	2,286
Pre-tax operating profit based on longer-term investment returns	4,319	(6)	–	4,313
Short-term fluctuations in investment returns:				
Before reclassification of held for sale Japan life business	538	–	5	543
Reclassification of Japan life business	(33)	–	–	(33)
	505	–	5	510
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	62	–	(62)	–
Effect of changes in economic assumptions:				
Before reclassification of held for sale Japan life business	(16)	–	–	(16)
Reclassification of Japan life business	14	–	–	14
	(2)	–	–	(2)
Profit attaching to held for sale Japan life business:				
Reclassification from pre-tax operating profit based on longer-term investment returns	2	–	–	2
Reclassification from short-term fluctuations in investment returns	33	–	–	33
Reclassification from effect of changes in economic assumptions	(14)	–	–	(14)
	21	–	–	21
Other items	115	–	–	115
Profit before tax	5,020	(6)	(57)	4,957
Tax attributable to shareholders' profit	(1,207)	6	13	(1,188)
Profit for the year attributable to shareholders	3,813	–	(44)	3,769
Items taken directly to shareholders' equity	(1,007)	–	44	(963)
Net increase in shareholders' equity	2,806	–	–	2,806
Total EPS based on post-tax profit (in pence)	150.1p	–	(1.8)p	148.3p

Notes on the EEV basis results continued

18 Additional information on the effect of the agreement to sell Japan life business and adoption of new and amended IFRS accounting standards continued

Summary statement of financial position

	31 Dec 2012 £m			
	As reported under previous basis	Effect of change		Under new policies
		IFRS 11 note (ii)	IAS 19	
Total net assets				
Total assets less liabilities, before deduction for insurance funds:	274,863	(3,095)	–	271,768
Less insurance funds:				
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds	(264,504)	3,095	–	(261,409)
Less shareholders' accrued interest in the long-term business	12,084	–	–	12,084
Total net assets	22,443	–	–	22,443

Notes

(i) Following the agreement in July 2013 to sell the Group's life insurance business in Japan, the results for the Japan life business have been shown separately in the Group's analysis of profit – see note 4.

(ii) Consistent with the requirements of IFRS 11, the Group's EEV pre-tax results now incorporate the post-tax results for asset management joint venture operations. For life insurance joint venture operations, the EEV results continue to be presented on a pre-tax basis, ie as for the Group's other insurance businesses.

(iii) Under the amended IAS 19 all actuarial gains and losses and related tax are recognised in the movement in shareholders' equity rather than in the summarised consolidated income statement.

Statement of directors' responsibilities in respect of the European Embedded Value (EEV) basis supplementary information

The directors have chosen to prepare supplementary information in accordance with the EEV Principles issued in May 2004 by the European CFO Forum as supplemented by the Additional Guidance on EEV Disclosures issued in October 2005.

When compliance with the EEV Principles is stated, those principles require the directors to prepare supplementary information in accordance with the Embedded Value Methodology (EVM) contained in the EEV Principles and to disclose and explain any non-compliance with the EEV guidance included in the EEV Principles.

In preparing the EEV supplementary information, the directors have:

— Prepared the supplementary information in accordance with the EEV Principles;

— Identified and described the business covered by the EVM;

— Applied the EVM consistently to the covered business;

— Determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;

— Made estimates that are reasonable and consistent; and

— Described the basis on which business that is not covered business has been included in the supplementary information, including any material departures from the accounting framework applicable to the Group's financial statements.

Independent auditor's report to Prudential plc on the European Embedded Value (EEV) basis supplementary information

Opinions and conclusions arising from our audit

Our opinion on the EEV basis supplementary information is unmodified

We have audited the EEV basis supplementary information of Prudential plc (the Company) for the year ended 31 December 2013 set out in the EEV basis results and Notes on the EEV basis results pages. The EEV basis supplementary information should be read in conjunction with the Group financial statements.

In our opinion, the EEV basis supplementary information of the Company for the year ended 31 December 2013 has been properly prepared, in all material respects, in accordance with the European Embedded Value Principles issued in May 2004 by the European CFO Forum as supplemented by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 (together 'the EEV Principles') using the methodology and assumptions set out in the Notes on the EEV basis results.

This report is made solely to the Company in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to the Company those matters we have been engaged to state in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 331, the directors have accepted responsibility for the preparation of the supplementary information on the EEV basis in accordance with the EEV Principles.

Our responsibility is to audit, and express an opinion on, the supplementary information in accordance with the terms of our engagement and in accordance with International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of an audit of financial statements performed in accordance with ISAs (UK and Ireland)

A description of the scope of an audit of financial statements is provided on our website at www.kpmg.com/uk/auditscopeother2013. This report is made subject to important explanations regarding our responsibilities, as published on that website, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

The purpose of this report and restrictions on its use by persons other than the Company

This report is made solely to the Company in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to the Company those matters we have been engaged to state in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our audit work, for this report, or for the opinions we have formed.

Rees Aronson

for and on behalf of KPMG Audit Plc, Chartered Accountants London

11 March 2014