C: Balance sheet notes

C1: Analysis of Group position by segment and business type

To explain more comprehensively the assets, liabilities and capital of the Group's businesses, it is appropriate to provide analyses of the Group's statement of financial position by operating segment and type of business.

C1.1 Group statement of financial position – analysis by segment

a Position as at 31 December 2013

		2013 £m							
		Insurance operations							
By operating segment	Note	**Asia** C2.1	**US** C2.2	**UK** C2.3	**Total insurance operations**	**Asset manage-ment operations** C2.4	**Unallo-cated to a segment (central opera-tions)**	**Intra-group elimina-tions**	**31 Dec Group total**
Assets note (i)									
Intangible assets attributable to shareholders:									
Goodwill	C5.1(a)	231	–	–	231	1,230	–	–	1,461
Deferred acquisition costs and other intangible assets	C5.1(b)	1,026	4,140	90	5,256	20	19	–	5,295
Total		1,257	4,140	90	5,487	1,250	19	–	6,756
Intangible assets attributable to with-profits funds:									
Goodwill in respect of acquired subsidiaries for venture fund and other investment purposes	C5.2(a)	–	–	177	177	–	–	–	177
Deferred acquisition costs and other intangible assets	C5.2(b)	66	–	6	72	–	–	–	72
Total		66	–	183	249	–	–	–	249
Total		1,323	4,140	273	5,736	1,250	19	–	7,005
Deferred tax assets	C8	55	2,042	142	2,239	119	54	–	2,412
Other non-investment and non-cash assets note (ii)		1,073	6,710	5,808	13,591	1,356	4,500	(7,090)	12,357
Investments of long-term business and other operations:									
Investment properties		1	28	11,448	11,477	–	–	–	11,477
Investments in joint ventures and associates accounted for using the equity method	D7	268	–	449	717	92	–	–	809
Financial investments:									
Loans	C3.4	922	6,375	4,173	11,470	1,096	–	–	12,566
Equity securities and portfolio holdings in unit trusts		14,383	66,008	39,745	120,136	65	21	–	120,222
Debt securities	C3.3	18,554	30,292	82,014	130,860	2,045	–	–	132,905
Other investments		41	1,557	4,603	6,201	61	3	–	6,265
Deposits		896	–	11,252	12,148	65	–	–	12,213
Total investments		35,065	104,260	153,684	293,009	3,424	24	–	296,457
Assets held for sale	D1	916	–	–	916	–	–	–	916
Cash and cash equivalents note (iii)		1,522	604	2,586	4,712	1,562	511	–	6,785
Total assets	C3.1	39,954	117,756	162,493	320,203	7,711	5,108	(7,090)	325,932

C: Balance sheet notes continued

C1: Analysis of Group position by segment and business type continued

		2013 £m							
		Insurance operations							
By operating segment	Note	**Asia**	**US**	**UK**	**Total insurance operations**	**Asset management operations**	**Unallocated to a segment (central operations)**	**Intra-group eliminations**	**31 Dec Group total**
Equity and liabilities									
Equity									
Shareholders' equity		2,795	3,446	2,998	9,239	1,991	(1,580)	–	9,650
Non-controlling interests		1	–	–	1	–	–	–	1
Total equity		2,796	3,446	2,998	9,240	1,991	(1,580)	–	9,651
Liabilities									
Policyholder liabilities and unallocated surplus of with-profits funds:									
Insurance contract liabilities		31,540	104,971	81,674	218,185	–	–	–	218,185
Investment contract liabilities with discretionary participation features		240	–	35,352	35,592	–	–	–	35,592
Investment contract liabilities without discretionary participation features		130	2,440	17,606	20,176	–	–	–	20,176
Unallocated surplus of with-profits funds		77	–	11,984	12,061	–	–	–	12,061
Total policyholder liabilities and unallocated surplus of with-profits funds	C4	31,987	107,411	146,616	286,014	–	–	–	286,014
Core structural borrowings of shareholder-financed operations:									
Subordinated debt		–	–	–	–	–	3,662	–	3,662
Other		–	150	–	150	275	549	–	974
Total	C6.1	–	150	–	150	275	4,211	–	4,636
Operational borrowings attributable to shareholder-financed operations	C6.2	–	142	74	216	3	1,933	–	2,152
Borrowings attributable to with-profits operations	C6.2	–	–	895	895	–	–	–	895
Other non-insurance liabilities:									
Obligations under funding, securities lending and sale and repurchase agreements		–	794	1,280	2,074	–	–	–	2,074
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		1,038	26	4,214	5,278	–	–	–	5,278
Deferred tax liabilities	C8.1	594	1,948	1,213	3,755	14	9	–	3,778
Current tax liabilities	C8.2	45	–	181	226	8	161	–	395
Accruals and deferred income		106	–	383	489	302	33	–	824
Other creditors		1,797	666	3,240	5,703	4,684	10	(7,090)	3,307
Provisions	C12	85	11	166	262	298	75	–	635
Derivative liabilities	C3.5(b)	58	515	804	1,377	112	200	–	1,689
Other liabilities[note (iv)]		580	2,647	429	3,656	24	56	–	3,736
Total		4,303	6,607	11,910	22,820	5,442	544	(7,090)	21,716
Liabilities held for sale	D1(c)	868	–	–	868	–	–	–	868
Total liabilities		37,158	114,310	159,495	310,963	5,720	6,688	(7,090)	316,281
Total equity and liabilities	C3.1	39,954	117,756	162,493	320,203	7,711	5,108	(7,090)	325,932

b Position as at 31 December 2012

By operating segment	Note	Insurance operations Asia C2.1	Insurance operations US C2.2	Insurance operations UK C2.3	Total insurance operations	Asset management operations C2.4	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec Group total
		2012* £m							
Assetsnote (i)									
Intangible assets attributable to shareholders:									
Goodwill	C5.1(a)	239	–	–	239	1,230	–	–	1,469
Deferred acquisition costs and other intangible assets	C5.2(b)	819	3,222	105	4,146	13	18	–	4,177
Total		1,058	3,222	105	4,385	1,243	18	–	5,646
Intangible assets attributable to with-profits funds:									
Goodwill in respect of acquired subsidiaries for venture fund and other investment purposes	C5.1(a)	–	–	178	178	–	–	–	178
Deferred acquisition costs and other intangible assets	C5.2(b)	72	–	6	78	–	–	–	78
Total		72	–	184	256	–	–	–	256
Total		1,130	3,222	289	4,641	1,243	18	–	5,902
Deferred tax assets	C8	76	1,889	183	2,148	106	52	–	2,306
Other non-investment and non-cash assetsnote (ii)		1,023	6,792	5,448	13,263	1,036	3,766	(6,113)	11,952
Investments of long-term business and other operations:									
Investment properties		2	24	10,528	10,554	–	–	–	10,554
Investments in joint ventures and associates accounted for using the equity method	D7	284	–	259	543	92	–	–	635
Financial investments:									
Loans	C3.4	1,006	6,235	4,303	11,544	1,199	–	–	12,743
Equity securities and portfolio holdings in unit trusts		12,730	49,551	36,281	98,562	64	–	–	98,626
Debt securities	C3.3	20,067	32,993	84,008	137,068	1,839	–	–	138,907
Other investments		927	2,296	4,256	7,479	41	27	–	7,547
Deposits		851	211	11,131	12,193	55	–	–	12,248
Total investments		35,867	91,310	150,766	277,943	3,290	27	–	281,260
Assets held for sale		–	–	98	98	–	–	–	98
Cash and cash equivalentsnote (iii)		1,545	513	2,668	4,726	918	482	–	6,126
Total assets	C3.1	39,641	103,726	159,452	302,819	6,593	4,345	(6,113)	307,644

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

C: Balance sheet notes continued

C1: Analysis of Group position by segment and business type continued

By operating segment	Note	2012* £m Insurance operations Asia C2.1	US C2.2	UK C2.3	Total insurance operations	Asset management operations C2.4	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec Group total
Equity and liabilities									
Equity									
Shareholders' equity		2,529	4,343	3,033	9,905	1,937	(1,483)	–	10,359
Non-controlling interests		4	–	1	5	–	–	–	5
Total equity		2,533	4,343	3,034	9,910	1,937	(1,483)	–	10,364
Liabilities									
Policyholder liabilities and unallocated surplus of with-profits funds:									
Insurance contract liabilities		31,026	90,192	84,266	205,484	–	–	–	205,484
Investment contract liabilities with discretionary participation features		348	–	33,464	33,812	–	–	–	33,812
Investment contract liabilities without discretionary participation features		127	2,069	16,182	18,378	–	–	–	18,378
Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds)		63	–	10,526	10,589	–	–	–	10,589
Total policyholder liabilities and unallocated surplus of with-profits funds	C4	31,564	92,261	144,438	268,263	–	–	–	268,263
Core structural borrowings of shareholder-financed operations:									
Subordinated debt		–	–	–	–	–	2,577	–	2,577
Other		–	153	–	153	275	549	–	977
Total	C6.1	–	153	–	153	275	3,126	–	3,554
Operational borrowings attributable to shareholder-financed operations	C6.2	7	26	127	160	1	2,084	–	2,245
Borrowings attributable to with-profits operations	C6.2	–	–	968	968	–	–	–	968
Other non-insurance liabilities:									
Obligations under funding, securities lending and sale and repurchase agreements		–	920	1,461	2,381	–	–	–	2,381
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		1,765	25	3,355	5,145	–	–	–	5,145
Deferred tax liabilities	C8.1	582	2,168	1,185	3,935	13	16	–	3,964
Current tax liabilities	C8.2	46	–	237	283	9	151	–	443
Accruals and deferred income		100	–	362	462	261	28	–	751
Other creditors		1,544	611	2,747	4,902	3,767	145	(6,113)	2,701
Provisions	C12	61	20	291	372	144	75	–	591
Derivative liabilities	C3.5(b)	837	645	1,010	2,492	150	190	–	2,832
Other liabilities[note (iv)]		602	2,554	237	3,393	36	13	–	3,442
Total		5,537	6,943	10,885	23,365	4,380	618	(6,113)	22,250
Total liabilities		37,108	99,383	156,418	292,909	4,656	5,828	(6,113)	297,280
Total equity and liabilities		39,641	103,726	159,452	302,819	6,593	4,345	(6,113)	307,644

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) The non-current assets of the Group comprise goodwill, intangible assets other than DAC and present value of acquired in-force business and property, plant and equipment included within 'other non-investment and non-cash assets'. Items defined as financial instruments or related to insurance contracts are excluded. The Group's total non-current assets at 31 December comprise:

	2013 £m	2012* £m
UK including insurance operations, M&G and central operations	2,090	1,927
US	157	152
Asia†	827	629
Total	3,074	2,708

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.
† No individual country in Asia held non-current assets at the end of the year which exceeded 10 per cent of the Group total.

(ii) Included within other non-investment and non-cash assets are accrued investment income of £2,609 million (2012: £2,771 million) and other debtors of £1,746 million (2012: £1,325 million).

	2013 £m	2012* £m
Accrued investment income		
Interest receivable	1,951	1,986
Other	658	785
Total	2,609	2,771
Other debtors comprises:		
Amounts due from		
Policyholders	303	257
Intermediaries	26	27
Reinsurers	16	21
Other	1,401	1,020
Total	1,746	1,325
Total accrued investment income and other debtors	4,355	4,096

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Of the other £4,355 million (2012: £4,096 million) of accrued investment income and other debtors, £350 million (2012: £523 million) is expected to be settled after one year or more.

(iii) Cash and cash equivalents consist of cash at bank and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 days' maturity from the date of acquisition. The component breakdown is as follows:

	2013 £m	2012* £m
Cash	5,605	4,696
Cash equivalents	1,180	1,430
Total cash and cash equivalents	6,785	6,126

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Of the total cash and cash equivalents £511 million (31 December 2012: £482 million) are held centrally and considered to be available for general use by the Group. The remaining funds are considered not to be available for general use by the Group, and include funds held for the benefit of policyholders.

(iv) Other liabilities comprise:

	2013 £m	2012* £m
Creditors arising from direct insurance and reinsurance operations	1,159	1,095
Interest payable	56	62
Other items†	2,521	2,285
Total	3,736	3,442

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.
† Of the £2,521 million (2012: £2,285 million) other items as at 31 December 2013, £2,051 million (2012: £2,021 million) related to liabilities for funds withheld under reinsurance arrangement of the Group's US operations from the purchase of REALIC, as discussed in note D1.

C: Balance sheet notes continued

C1: Analysis of Group position by segment and business type continued

C1.2 Group statement of financial position – analysis by business type

	Note	2013 £m							2012* £m
		Policyholder	Shareholder-backed business						
	Note	Participating funds	Unit-linked and variable annuity	Non-linked business	Asset management operations	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec Group total	31 Dec Group total
Assets									
Intangible assets attributable to shareholders:									
Goodwill	C5.1	–	–	231	1,230	–	–	1,461	1,469
Deferred acquisition costs and other intangible assets	C5.1	–	–	5,256	20	19	–	5,295	4,177
Total		–	–	5,487	1,250	19	–	6,756	5,646
Intangible assets attributable to with-profits funds:									
In respect of acquired subsidiaries for venture fund and other investment purposes		177	–	–	–	–	–	177	178
Deferred acquisition costs and other intangible assets		72	–	–	–	–	–	72	78
Total		249	–	–	–	–	–	249	256
Total		249	–	5,487	1,250	19	–	7,005	5,902
Deferred tax assets	C8	83	1	2,155	119	54	–	2,412	2,306
Other non-investment and non-cash assets		3,331	599	9,661	1,356	4,500	(7,090)	12,357	11,952
Investments of long-term business and other operations:									
Investment properties		9,260	645	1,572	–	–	–	11,477	10,554
Investments in joint ventures and associates accounted for using the equity method		383	–	334	92	–	–	809	635
Financial investments:									
Loans	C3.4	3,346	–	8,124	1,096	–	–	12,566	12,743
Equity securities and portfolio holdings in unit trusts		28,365	90,872	899	65	21	–	120,222	98,626
Debt securities	C3.3	57,791	9,622	63,447	2,045	–	–	132,905	138,907
Other investments		4,309	36	1,856	61	3	–	6,265	7,547
Deposits		9,486	1,024	1,638	65	–	–	12,213	12,248
Total investments		112,940	102,199	77,870	3,424	24	–	296,457	281,260
Assets held for sale	D1	–	328	588	–	–	–	916	98
Cash and cash equivalents		1,952	982	1,778	1,562	511	–	6,785	6,126
Total assets		118,555	104,109	97,539	7,711	5,108	(7,090)	325,932	307,644

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

	Note	2013 £m							2012* £m
		Policyholder	Shareholder-backed business						
	Note	Participating funds	Unit-linked and variable annuity	Non-linked business	Asset management operations	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec Group total	31 Dec Group total
Equity and liabilities									
Equity									
Shareholders' equity		–	–	9,239	1,991	(1,580)	–	9,650	10,359
Non-controlling interests		–	–	1	–	–	–	1	5
Total equity		–	–	9,240	1,991	(1,580)	–	9,651	10,364
Liabilities									
Policyholder liabilities and unallocated surplus of with-profits funds:									
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)		96,991	101,251	75,711	–	–	–	273,953	257,674
Unallocated surplus of with-profits funds		12,061	–	–	–	–	–	12,061	10,589
Total policyholder liabilities and unallocated surplus of with-profits funds	C4	109,052	101,251	75,711	–	–	–	286,014	268,263
Core structural borrowings of shareholder-financed operations:									
Subordinated debt		–	–	–	–	3,662	–	3,662	2,577
Other		–	–	150	275	549	–	974	977
Total	C6.1	–	–	150	275	4,211	–	4,636	3,554
Operational borrowings attributable to shareholder-financed operations	C6.2	–	–	216	3	1,933	–	2,152	2,245
Borrowings attributable to with-profits operations	C6.2	895	–	–	–	–	–	895	968
Deferred tax liabilities	C8	1,192	44	2,519	14	9	–	3,778	3,964
Other non-insurance liabilities		7,416	2,486	9,163	5,428	535	(7,090)	17,938	18,286
Liabilities held for sale	D1	–	328	540	–	–	–	868	–
Total liabilities		118,555	104,109	88,299	5,720	6,688	(7,090)	316,281	297,280
Total equity and liabilities		118,555	104,109	97,539	7,711	5,108	(7,090)	325,932	307,644

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

C: Balance sheet notes continued

C2: Analysis of segment position by business type

To show the statement of financial position by reference to the differing degrees of policyholder and shareholder economic interest of the different types of business, the analysis below is structured to show separately assets and liabilities of each segment by business type.

C2.1 Asia insurance operations

	2013 £m				2012* £m
	With-profits business note (i)	**Unit-linked assets and liabilities**	**Other business**	**31 Dec Total**	**31 Dec Total**
Assets					
Intangible assets attributable to shareholders:					
Goodwill	–	–	231	231	239
Deferred acquisition costs and other intangible assets	–	–	1,026	1,026	819
Total	–	–	1,257	1,257	1,058
Intangible assets attributable to with-profits funds:					
Deferred acquisition costs and other intangible assets	66	–	–	66	72
Deferred tax assets	–	1	54	55	76
Other non-investment and non-cash assets	320	131	622	1,073	1,023
Investments of long-term business and other operations:					
Investment properties	–	–	1	1	2
Investments in joint ventures and associates accounted for using the equity method	–	–	268	268	284
Financial investments:					
Loans[C3.4]	522	–	400	922	1,006
Equity securities and portfolio holdings in unit trusts	4,538	9,274	571	14,383	12,730
Debt securities[C3.3]	9,736	2,451	6,367	18,554	20,067
Other investments	8	21	12	41	927
Deposits	304	260	332	896	851
Total investments	15,108	12,006	7,951	35,065	35,867
Assets held for sale	–	328	588	916	–
Cash and cash equivalents	392	332	798	1,522	1,545
Total assets	15,886	12,798	11,270	39,954	39,641
Equity and liabilities					
Equity					
Shareholders' equity	–	–	2,795	2,795	2,529
Non-controlling interests	–	–	1	1	4
Total equity	–	–	2,796	2,796	2,533
Liabilities					
Policyholder liabilities and unallocated surplus of with-profits funds:					
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	13,138	11,918	6,854	31,910	31,501
Unallocated surplus of with-profits funds[note (ii)]	77	–	–	77	63
Total[C4.1(b)]	13,215	11,918	6,854	31,987	31,564
Operational borrowings attributable to shareholder-financed operations	–	–	–	–	7
Deferred tax liabilities	403	44	147	594	582
Other non-insurance liabilities	2,268	508	933	3,709	4,955
Liabilities held for sale	–	328	540	868	–
Total liabilities	15,886	12,798	8,474	37,158	37,108
Total equity and liabilities	15,886	12,798	11,270	39,954	39,641

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore with-profits operations. Assets and liabilities of other participating business are included in the column for 'Other business'.

(ii) For the purposes of the presentation of unallocated surplus of with-profits within the statement of financial position, the Hong Kong branch balance is reported within the unallocated surplus of the PAC with-profits sub-fund of the UK insurance operations.

C2.2 US insurance operations

	2013 £m			2012 £m
	Variable annuity separate account assets and liabilities note (i)	Fixed annuity, GIC and other business note (i)	31 Dec Total	31 Dec Total
Assets				
Intangible assets attributable to shareholders:				
Deferred acquisition costs and other intangibles	–	4,140	4,140	3,222
Total	–	4,140	4,140	3,222
Deferred tax assets	–	2,042	2,042	1,889
Other non-investment and non-cash assets note (iv)	–	6,710	6,710	6,792
Investments of long-term business and other operations:				
Investment properties	–	28	28	24
Financial investments:				
Loans C3.4	–	6,375	6,375	6,235
Equity securities and portfolio holdings in unit trusts note (iii)	65,681	327	66,008	49,551
Debt securities C3.3	–	30,292	30,292	32,993
Other investments note (ii)	–	1,557	1,557	2,296
Deposits	–	–	–	211
Total investments	65,681	38,579	104,260	91,310
Cash and cash equivalents	–	604	604	513
Total assets	65,681	52,075	117,756	103,726
Equity and liabilities				
Equity				
Shareholders' equity note (vi)	–	3,446	3,446	4,343
Total equity	–	3,446	3,446	4,343
Liabilities				
Policyholder liabilities:				
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) note (v)	65,681	41,730	107,411	92,261
Total C4.1(c)	65,681	41,730	107,411	92,261
Core structural borrowings of shareholder-financed operations	–	150	150	153
Operational borrowings attributable to shareholder-financed operations	–	142	142	26
Deferred tax liabilities	–	1,948	1,948	2,168
Other non-insurance liabilities note (v)	–	4,659	4,659	4,775
Total liabilities	65,681	48,629	114,310	99,383
Total equity and liabilities	65,681	52,075	117,756	103,726

Notes

(i) These amounts are for Separate Account assets and liabilities for all variable annuity products comprising those with and without guarantees. Assets and liabilities attaching to variable annuity business that are not held in the separate account eg in respect of guarantees are shown within other business.

(ii) Other investments comprise:

	2013 £m	2012 £m
Derivative assets*	766	1,546
Partnerships in investment pools and other†	791	750
	1,557	2,296

* After taking account of the derivative liabilities of £515 million (2012: £645 million), which are also included in Other non-insurance liabilities, the derivative position for US operations is a net asset of £251 million (2012: £901 million).

† Partnerships in investment pools and other comprise primarily investments in limited partnerships. These include interests in the PPM America Private Equity Fund and diversified investments in 166 (2012: 167) other partnerships by independent money managers that generally invest in various equities and fixed income loans and securities.

(iii) Equity securities and portfolio holdings in unit trusts includes investments in mutual funds, the majority of which are equity-based.

(iv) Included within other non-investment and non-cash assets of £6,710 million (2012: £6,792 million) were balances of £6,065 million (2012: £6,076 million) for reinsurers' share of insurance contract liabilities. Of the £6,065 million as at 31 December 2013, £5,410 million related to the reinsurance ceded by the REALIC business acquired in 2012 (2012: £5,234 million). REALIC holds collateral for certain of these reinsurance arrangements with a corresponding funds withheld liability. As of 31 December 2013, the funds withheld liability of £2,051 million (2012: £2,021 million) was recorded within other non-insurance liabilities.

C: Balance sheet notes continued

C2: Analysis of segment position by business type continued

(v) In addition to the policyholder liabilities above, Jackson has entered into a programme of funding arrangements under contracts, which, in substance are almost identical to GICs. The liabilities under these funding agreements totalled £485 million (2012: £825 million) and are included in other non-insurance liabilities in the statement of financial position above.

(vi) Changes in shareholders' equity.

	2013 £m	**2012** £m
Operating profit based on longer-term investment returns[B1.1]	1,243	964
Short-term fluctuations in investment returns[B1.2]	(625)	(90)
Amortisation of acquisition accounting adjustments arising on the purchase of REALIC	(65)	(19)
Profit before shareholder tax	553	855
Tax[B5]	(101)	(234)
Profit for the year	452	621

	2013 £m	**2012** £m
Profit for the year (as above)	452	621
Items recognised in other comprehensive income:		
Exchange movements	(32)	(181)
Unrealised valuation movements on securities classified as available-for-sale:		
Unrealised holding (losses) gains arising during the year	(2,025)	930
Deduct net gains included in the income statement	(64)	(68)
Total unrealised valuation movements	(2,089)	862
Related change in amortisation of deferred acquisition costs[C5.1(b)]	498	(270)
Related tax	557	(205)
Total other comprehensive (loss) income	(1,066)	206
Total comprehensive (loss) income for the year	(614)	827
Dividends, interest payments to central companies and other movements	(283)	(245)
Net (decrease) increase in equity	(897)	582
Shareholders' equity at beginning of year	4,343	3,761
Shareholders' equity at end of year	3,446	4,343

C2.3 UK insurance operations

Of the total investments of £154 billion in UK insurance operations, £98 billion of investments are held by SAIF and the PAC WPSF. Shareholders are exposed only indirectly to value movements on these assets.

By operating segment	2013 £m						2012* £m
			Other funds and subsidiaries				
	Scottish Amicable Insurance Fund note (iii)	PAC with-profits sub-fund notes (i),(ii)	Unit-linked assets and liabilities	Annuity and other long-term business	Total	31 Dec Total	31 Dec Total
Assets							
Intangible assets attributable to shareholders:							
Deferred acquisition costs and other intangible assets	–	–	–	90	90	90	105
Total	–	–	–	90	90	90	105
Intangible assets attributable to with-profits funds:							
In respect of acquired subsidiaries for venture fund and other investment purposes	–	177	–	–	–	177	178
Deferred acquisition costs	–	6	–	–	–	6	6
Total	–	183	–	–	–	183	184
Total	–	183	–	90	90	273	289
Deferred tax assets	1	82	–	59	59	142	183
Other non-investment and non-cash assets	267	2,744	468	2,329	2,797	5,808	5,448
Investments of long-term business and other operations:							
Investment properties	456	8,804	645	1,543	2,188	11,448	10,528
Investments in joint ventures and associates accounted for using the equity method	–	383	–	66	66	449	259
Financial investments:							
Loans [C3.4]	96	2,728	–	1,349	1,349	4,173	4,303
Equity securities and portfolio holdings in unit trusts	2,060	21,767	15,917	1	15,918	39,745	36,281
Debt securities [C3.3]	3,340	44,715	7,171	26,788	33,959	82,014	84,008
Other investments [note (iv)]	315	3,986	15	287	302	4,603	4,256
Deposits	694	8,488	764	1,306	2,070	11,252	11,131
Total investments	6,961	90,871	24,512	31,340	55,852	153,684	150,766
Assets held for sale	–	–	–	–	–	–	98
Cash and cash equivalents	196	1,364	650	376	1,026	2,586	2,668
Total assets	7,425	95,244	25,630	34,194	59,824	162,493	159,452

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

C: Balance sheet notes continued

C2: Analysis of segment position by business type continued

	2013 £m						2012* £m
			Other funds and subsidiaries				
	Scottish Amicable Insurance Fund note (iii)	PAC with-profits sub-fund notes (i),(ii)	Unit-linked assets and liabilities	Annuity and other long-term business	Total	31 Dec Total	31 Dec Total
Equity and liabilities							
Equity							
Shareholders' equity	–	–	–	2,998	2,998	2,998	3,033
Non-controlling interests	–	–	–	–	–	–	1
Total equity	–	–	–	2,998	2,998	2,998	3,034
Liabilities							
Policyholder liabilities and unallocated surplus of with-profits funds:							
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	7,112	76,741	23,652	27,127	50,779	134,632	133,912
Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds)[C4.1(d)]	–	11,984	–	–	–	11,984	10,526
Total	7,112	88,725	23,652	27,127	50,779	146,616	144,438
Operational borrowings attributable to shareholder-financed operations	–	–	–	74	74	74	127
Borrowings attributable to with-profits funds	12	883	–	–	–	895	968
Deferred tax liabilities	53	736	–	424	424	1,213	1,185
Other non-insurance liabilities	248	4,900	1,978	3,571	5,549	10,697	9,700
Total liabilities	7,425	95,244	25,630	31,196	56,826	159,495	156,418
Total equity and liabilities	7,425	95,244	25,630	34,194	59,824	162,493	159,452

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) The PAC with-profits sub-fund (WPSF) mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). Included in the PAC with-profits fund is £12.2 billion (2012: £13.3 billion) of non-profits annuities liabilities. The WPSF's profits are apportioned 90 per cent to its policyholders and 10 per cent to shareholders as surplus for distribution is determined via the annual actuarial valuation. For the purposes of this table and subsequent explanation, references to the WPSF also include, for convenience, the amounts attaching to the Defined Charges Participating Sub-fund which comprises 3.6 per cent of the total assets of the WPSF and includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 1 December 2007 (with assets of approximately £1.7 billion). Profits to shareholders on this with-profits annuity business emerge on a 'charges less expenses' basis and policyholders are entitled to 100 per cent of the investment earnings.

(ii) The Hong Kong branch balance is reported within the unallocated surplus of the PAC with-profits sub-fund and excludes policyholder liabilities of the Hong Kong branch of PAC.

(iii) The fund is solely for the benefit of policyholders of SAIF. Shareholders have no interest in the profits of this fund although they are entitled to asset management fees on this business. SAIF is a separate sub-fund within the PAC long-term business fund.

(iv) Other investments comprise:

	2013 £m	2012* £m
Derivative assets†	1,472	1,349
Partnerships in investment pools and other‡	3,131	2,907
	4,603	4,256

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

† After including derivative liabilities of £804 million (2012: £1,010 million), which are also included in the statement of financial position, the overall derivative position was a net asset of £668 million (2012: £339 million).

‡ Partnerships in investment pools and other comprise mainly investments held by the PAC with-profits fund. These investments are primarily investments in limited partnerships and, additionally, investments in property funds.

C2.4 Asset management operations

	2013 £m				2012* £m
	M&G note (i)	**US**	**Eastspring Investments**	**31 Dec Total**	**31 Dec Total**
Assets					
Intangible assets:					
Goodwill	1,153	16	61	1,230	1,230
Deferred acquisition costs and other intangible assets	17	2	1	20	13
Total	1,170	18	62	1,250	1,243
Other non-investment and non-cash assets	1,210	198	67	1,475	1,142
Investments in joint ventures and associates accounted for using the equity method	34	–	58	92	92
Financial investments:					
Loans[C3.4]	1,096	–	–	1,096	1,199
Equity securities and portfolio holdings in unit trusts	54	–	11	65	64
Debt securities[C3.3]	2,045	–	–	2,045	1,839
Other investments	47	14	–	61	41
Deposits	–	32	33	65	55
Total investments	3,276	46	102	3,424	3,290
Cash and cash equivalents	1,405	56	101	1,562	918
Total assets	7,061	318	332	7,711	6,593
Equity and liabilities					
Equity					
Shareholders' equity	1,602	134	255	1,991	1,937
Total equity	1,602	134	255	1,991	1,937
Liabilities					
Core structural borrowing of shareholder-financed operations	275	–	–	275	275
Intra-group debt represented by operational borrowings at Group level[note (ii)]	1,933	–	–	1,933	2,084
Other non-insurance liabilities[note (iii)]	3,251	184	77	3,512	2,297
Total liabilities	5,459	184	77	5,720	4,656
Total equity and liabilities	7,061	318	332	7,711	6,593

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) The M&G statement of financial position includes the assets and liabilities in respect of Prudential Capital.

(ii) Intra-group debt represented by operational borrowings at Group level.
Operational borrowings for M&G are in respect of Prudential Capital's short-term fixed income security programme and comprise:

	2013 £m	**2012** £m
Commercial paper	1,634	1,535
Medium Term Notes	299	549
Total intra-group debt represented by operational borrowings at Group level	1,933	2,084

(iii) Other non-insurance liabilities consist primarily of intra-group balances, derivative liabilities and other creditors.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement

C3.1 Group assets and liabilities – Classification

The classification of the Group's assets and liabilities, and its corresponding accounting carrying values reflect the requirements of IFRS. For financial investments the basis of valuation reflects the Group's application of IAS 39 'Financial Instruments: Recognition and Measurement' as described further below. Where assets and liabilities have been valued at fair value or measured on a different basis but fair value is disclosed, the Group has followed the principles under IFRS 13 'Fair Value Measurement'. The basis applied is summarised below:

	2013 £m				
	At fair value		Cost/ Amortised cost/ IFRS 4 basis value note (i)	Total carrying value	Fair value, where applicable
	Through profit and loss	Available-for-sale			
Intangible assets attributable to shareholders:					
Goodwill	–	–	1,461	1,461	
Deferred acquisition costs and other intangible assets	–	–	5,295	5,295	
Total	–	–	6,756	6,756	
Intangible assets attributable to with-profits funds:					
In respect of acquired subsidiaries for venture fund and other investment purposes	–	–	177	177	
Deferred acquisition costs and other intangible assets	–	–	72	72	
Total	–	–	249	249	
Total intangible assets	–	–	7,005	7,005	
Other non-investment and non-cash assets:					
Property, plant and equipment	–	–	920	920	
Reinsurers' share of insurance contract liabilities	–	–	6,838	6,838	
Deferred tax assets	–	–	2,412	2,412	
Current tax recoverable	–	–	244	244	
Accrued investment income	–	–	2,609	2,609	2,609
Other debtors	–	–	1,746	1,746	1,746
Total	–	–	14,769	14,769	
Investments of long-term business and other operations note (ii):					
Investment properties	11,477	–	–	11,477	11,477
Investments accounted for using the equity method	–	–	809	809	
Loans note (iv)	2,137	–	10,429	12,566	12,995
Equity securities and portfolio holdings in unit trusts	120,222	–	–	120,222	120,222
Debt securities note (v)	102,700	30,205	–	132,905	132,905
Other investments note (vi)	6,265	–	–	6,265	6,265
Deposits	–	–	12,213	12,213	12,213
Total investments	242,801	30,205	23,451	296,457	
Assets held for sale	916	–	–	916	916
Cash and cash equivalents	–	–	6,785	6,785	6,785
Total assets	243,717	30,205	52,010	325,932	

	2013 £m				
	At fair value		Cost/ Amortised cost/ IFRS 4 basis value note (i)	Total carrying value	Fair value, where applicable
	Through profit and loss	Available-for-sale			
Liabilities					
Policyholder liabilities and unallocated surplus of with-profits funds:					
Insurance contract liabilities	–	–	218,185	218,185	
Investment contract liabilities with discretionary participation features[note (iii)]	–	–	35,592	35,592	
Investment contract liabilities without discretionary participation features	17,736	–	2,440	20,176	20,177
Unallocated surplus of with-profits funds	–	–	12,061	12,061	
Total	17,736	–	268,278	286,014	
Core structural borrowings of shareholder-financed operations:	–	–	4,636	4,636	5,066
Other borrowings:					
Operational borrowings attributable to shareholder-financed operations	–	–	2,152	2,152	2,152
Borrowings attributable to with-profits operations	18	–	877	895	909
Other non-insurance liabilities:					
Obligations under funding, securities lending and sale and repurchase agreements	–	–	2,074	2,074	2,085
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	5,278	–	–	5,278	5,278
Deferred tax liabilities	–	–	3,778	3,778	
Current tax liabilities	–	–	395	395	
Accruals and deferred income	–	–	824	824	
Other creditors	263	–	3,044	3,307	3,307
Provisions	–	–	635	635	
Derivative liabilities	1,689	–	–	1,689	1,689
Other liabilities	2,051	–	1,685	3,736	3,736
Total	9,281	–	12,435	21,716	
Liabilities held for sale	868	–	–	868	868
Total liabilities	27,903	–	288,378	316,281	

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

	2012* £m				
	At fair value		**Cost/ Amortised cost/ IFRS 4 basis value** note (i)	**Total carrying value**	**Fair value, where applicable**
	Through profit and loss	**Available-for-sale**			
Intangible assets attributable to shareholders:					
Goodwill	–	–	1,469	1,469	
Deferred acquisition costs and other intangible assets	–	–	4,177	4,177	
Total	–	–	5,646	5,646	
Intangible assets attributable to with-profits funds:					
In respect of acquired subsidiaries for venture fund and other investment purposes	–	–	178	178	
Deferred acquisition costs and other intangible assets	–	–	78	78	
Total	–	–	256	256	
Total intangible assets	–	–	5,902	5,902	
Other non-investment and non-cash assets:					
Property, plant and equipment	–	–	754	754	
Reinsurers' share of insurance contract liabilities	–	–	6,854	6,854	
Deferred tax assets	–	–	2,306	2,306	
Current tax recoverable	–	–	248	248	
Accrued investment income	–	–	2,771	2,771	2,771
Other debtors	–	–	1,325	1,325	1,325
Total	–	–	14,258	14,258	
Investments of long-term business and other operations[note (ii)]:					
Investment properties	10,554	–	–	10,554	10,554
Investments accounted for using the equity method	–	–	635	635	
Loans[note (iv)]	2,068	–	10,675	12,743	13,255
Equity securities and portfolio holdings in unit trusts	98,626	–	–	98,626	98,626
Debt securities[note (v)]	106,082	32,825	–	138,907	138,907
Other investments[note (vi)]	7,547	–	–	7,547	7,547
Deposits	–	–	12,248	12,248	12,248
Total investments	224,877	32,825	23,558	281,260	
Assets held for sale	98	–	–	98	98
Cash and cash equivalents	–	–	6,126	6,126	6,126
Total assets	224,975	32,825	49,844	307,644	

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

	2012* £m				
	At fair value		Cost/ Amortised cost/ IFRS 4 basis value note (i)	Total carrying value	Fair value, where applicable
	Through profit and loss	Available-for-sale			
Liabilities					
Policyholder liabilities and unallocated surplus of with-profits funds:					
Insurance contract liabilities	–	–	205,484	205,484	
Investment contract liabilities with discretionary participation features note (iii)	–	–	33,812	33,812	
Investment contract liabilities without discretionary participation features	16,309	–	2,069	18,378	18,419
Unallocated surplus of with-profits funds	–	–	10,589	10,589	
Total	16,309	–	251,954	268,263	
Core structural borrowings of shareholder-financed operations:	–	–	3,554	3,554	4,133
Other borrowings:					
Operational borrowings attributable to shareholder-financed operations	–	–	2,245	2,245	2,245
Borrowings attributable to with-profits operations	40	–	928	968	977
Other non-insurance liabilities:					
Obligations under funding, securities lending and sale and repurchase agreements	–	–	2,381	2,381	2,400
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	5,145	–	–	5,145	5,145
Deferred tax liabilities	–	–	3,964	3,964	
Current tax liabilities	–	–	443	443	
Accruals and deferred income	–	–	751	751	
Other creditors	259	–	2,442	2,701	2,701
Provisions	–	–	591	591	
Derivative liabilities	2,832	–	–	2,832	2,832
Other liabilities	2,021	–	1,421	3,442	3,442
Total	10,257	–	11,993	22,250	
Total liabilities	26,606	–	270,674	297,280	

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) Assets carried at cost or amortised cost are subject to impairment testing where appropriate under IFRS requirements. This category also includes assets which are valued by reference to specific IFRS standards such as reinsurers' share of insurance contract liabilities, deferred tax assets and investments accounted for under the equity method.

(ii) Realised gains and losses on the Group's investments for 2013 recognised in the income statement amounted to a net gain of £2.5 billion (2012: £6.8 billion).

(iii) The carrying value of investment contracts with discretionary participation features is on IFRS 4 basis. It is impractical to determine the fair value of these contracts due to the lack of a reliable basis to measure participation features.

(iv) Loans and receivables are reported net of allowance for loan losses of £62 million (2012: £83 million).

(v) As at 31 December 2013 £495 million (2012: £525 million) of convertible bonds were included in debt securities and £1,078 million (2012: £673 million) were included in borrowings.

(vi) See note C3.5(b) for details of the derivative assets included. The balance also contains the PAC with-profits fund's participation in various investment funds and limited liability property partnerships.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

C3.2 Group assets and liabilities – Measurement

The section provides detail of the designation and valuation of the Group's financial assets and liabilities shown under the following categories:

a Determination of fair value

The fair values of the assets and liabilities of the Group have been determined on the following bases.

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments, or by using quotations from independent third-parties, such as brokers and pricing services or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm's length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third parties or valued internally using standard market practices.

The loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The rate of discount used was the market rate of interest where applicable.

The fair value of investment properties is based on market values as assessed by professionally qualified external valuers or by the Group's qualified surveyors.

The fair value of the subordinated and senior debt issued by the parent company is determined using the quoted prices from independent third parties.

The fair value of financial liabilities (other than derivative financial instruments) is determined using discounted cash flows of the amounts expected to be paid.

b Fair value measurement hierarchy of Group assets and liabilities

Assets and liabilities carried at fair value on the statement of financial position

The table below shows the assets and liabilities carried at fair value analysed by level of the IFRS 13 'Fair Value Measurement' defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

Financial instruments at fair value

	31 Dec 2013 £m			
	Level 1	Level 2	Level 3	Total
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Equity securities and portfolio holdings in unit trusts	25,087	2,709	569	28,365
Debt securities	14,547	42,759	485	57,791
Other investments (including derivative assets)	169	1,191	2,949	4,309
Derivative liabilities	(32)	(517)	–	(549)
Total financial investments, net of derivative liabilities	39,771	46,142	4,003	89,916
Percentage of total	44%	52%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	90,645	191	36	90,872
Debt securities	3,573	6,048	1	9,622
Other investments (including derivative assets)	6	30	–	36
Derivative liabilities	(1)	(3)	–	(4)
Total financial investments, net of derivative liabilities	94,223	6,266	37	100,526
Percentage of total	94%	6%	0%	100%
Non-linked shareholder-backed				
Loans	–	250	1,887	2,137
Equity securities and portfolio holdings in unit trusts	841	100	44	985
Debt securities	13,428	51,880	184	65,492
Other investments (including derivative assets)	–	1,111	809	1,920
Derivative liabilities	–	(935)	(201)	(1,136)
Total financial investments, net of derivative liabilities	14,269	52,406	2,723	69,398
Percentage of total	21%	75%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	250	1,887	2,137
Equity securities and portfolio holdings in unit trusts	116,573	3,000	649	120,222
Debt securities	31,548	100,687	670	132,905
Other investments (including derivative assets)	175	2,332	3,758	6,265
Derivative liabilities	(33)	(1,455)	(201)	(1,689)
Total financial investments, net of derivative liabilities	148,263	104,814	6,763	259,840
Investment contracts liabilities without discretionary participation features held at fair value	–	(17,736)	–	(17,736)
Borrowings attributable to the with-profits funds held at fair value	–	(18)	–	(18)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(3,703)	(248)	(1,327)	(5,278)
Other financial liabilities held at fair value	–	(263)	(2,051)	(2,314)
Total financial instruments at fair value	144,560	86,549	3,385	234,494
Percentage of total	61%	37%	2%	100%

In addition to the financial instruments shown above, the assets and liabilities held for sale on the consolidated statement of financial position at 31 December 2013 in respect of Japan life business included a net financial instruments balance of £934 million, primarily for equity securities and debt securities. Of this amount, £905 million has been classified as level 1 and £29 million as level 2.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

	31 Dec 2012* £m			
	Level 1	Level 2	Level 3	Total
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Equity securities and portfolio holdings in unit trusts	22,057	2,496	480	25,033
Debt securities	16,056	45,550	542	62,148
Other investments (including derivative assets)	108	1,743	2,574	4,425
Derivative liabilities	(61)	(1,075)	–	(1,136)
Total financial investments, net of derivative liabilities	38,160	48,714	3,596	90,470
Percentage of total	42%	54%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	72,488	183	39	72,710
Debt securities	3,660	5,409	2	9,071
Other investments (including derivative assets)	26	10	–	36
Derivative liabilities	–	(1)	–	(1)
Total financial investments, net of derivative liabilities	76,174	5,601	41	81,816
Percentage of total	93%	7%	0%	100%
Non-linked shareholder-backed				
Loans	–	226	1,842	2,068
Equity securities and portfolio holdings in unit trusts	827	7	49	883
Debt securities	13,357	54,146	185	67,688
Other investments (including derivative assets)	24	2,301	761	3,086
Derivative liabilities	(16)	(1,484)	(195)	(1,695)
Total financial investments, net of derivative liabilities	14,192	55,196	2,642	72,030
Percentage of total	20%	76%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	226	1,842	2,068
Equity securities and portfolio holdings in unit trusts	95,372	2,686	568	98,626
Debt securities	33,073	105,105	729	138,907
Other investments (including derivative assets)	158	4,054	3,335	7,547
Derivative liabilities	(77)	(2,560)	(195)	(2,832)
Total financial investments, net of derivative liabilities	128,526	109,511	6,279	244,316
Investment contracts liabilities without discretionary participation features held at fair value	–	(16,309)	–	(16,309)
Borrowings attributable to the with-profits fund held at fair value	–	(40)	–	(40)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(3,653)	(268)	(1,224)	(5,145)
Other financial liabilities held at fair value	–	(259)	(2,021)	(2,280)
Total financial instruments at fair value	124,873	92,635	3,034	220,542
Percentage of total	57%	42%	1%	100%

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Investment properties at fair value

Group total	Level 1 Quoted prices (unadjusted) in active markets	Level 2 Valuation based on significant observable market inputs	Level 3 Valuation based on significant unobservable market inputs	Total
	31 Dec 2013 £m			
Investment properties	–	–	11,477	11,477

Assets and liabilities at amortised cost for which fair value is disclosed

The table below shows the assets and liabilities carried at amortised cost on the statement of financial position but for which fair value is disclosed in the financial statements. The assets and liabilities that are carried at amortised cost but where the carrying value approximates the fair value, are excluded from the analysis below.

	Level 1 Quoted prices (unadjusted) in active markets	Level 2 Valuation based on significant observable market inputs	Level 3 Valuation based on significant unobservable market inputs	Total
	31 Dec 2013 £m			
Assets				
Loans	–	3,778	7,080	10,858
Liabilities				
Investment contract liabilities without discretionary participation features	–	–	(2,441)	(2,441)
Core structural borrowings of shareholder-financed operations	–	(4,878)	(188)	(5,066)
Operational borrowings attributable to shareholder-financed operations	–	(2,010)	(142)	(2,152)
Borrowings attributable to the with-profits funds	–	(798)	(93)	(891)
Obligations under funding, securities lending and sale and repurchase agreements	–	(1,589)	(496)	(2,085)

The fair value of the assets and liabilities in the table above, with the exception of the subordinated and senior debt issued by the parent company, has been estimated from the discounted cash flows expected to be received or paid. Where appropriate, the observable market interest rate has been used and the assets and liabilities are classified within level 2. Otherwise, they are included as level 3 assets or liabilities.

The fair value included for the subordinated and senior debt issued by the parent company is determined using the quoted prices from independent third parties.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

c Valuation approach for level 2 fair valued assets and liabilities

A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain the third-party broker quotes. Where pricing services providers are used, a single valuation is obtained and applied.

When prices are not available from pricing services, quotes are sourced directly from brokers. Prudential seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness and regularity of the quotes and the accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third-party valuations obtained do not reflect fair value (eg either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation. In these instances, prices are derived using internal valuation techniques including those as described above in this note with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. Prudential determines the input assumptions based on the best available information at the measurement dates. Securities valued in such manner are classified as level 3 where these significant inputs are not based on observable market data.

Of the total level 2 debt securities of £100,687 million at 31 December 2013 (2012: £105,105 million), £8,556 million are valued internally (2012: £8,248 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

d Fair value measurements for level 3 fair valued assets and liabilities

Reconciliation of movements in level 3 assets and liabilities measured at fair value

The following table reconciles the value of level 3 fair valued assets and liabilities at 1 January 2013 to that presented at 31 December 2013.

Total investment return recorded in the income statement represents interest and dividend income, realised gains and losses, unrealised gains and losses on the assets classified at fair value through profit and loss and foreign exchange movements on an individual entity's overseas investments.

Total gains and losses recorded in other comprehensive income includes unrealised gains and losses on debt securities held as available-for-sale within Jackson and foreign exchange movements arising from the retranslation of the Group's overseas subsidiaries and branches.

Financial instruments at fair value

	£m											
	At 1 Jan	Total gains/ losses in income statement	Total gains/ losses recorded in other compre-hensive income	Acqui-sition of REALIC in 2012	Purchases	Sales	Settled	Issued	Reclassi-fication of Japan life as held for sale	Transfers into level 3	Transfers out of level 3	At 31 Dec
2013												
Loans	1,842	4	(37)	–	–	–	(66)	144	–	–	–	1,887
Equity securities and portfolio holdings in unit trusts	568	50	(3)	–	26	(73)	–	–	–	84	(3)	649
Debt securities	729	60	(4)	–	16	(146)	(1)	–	(28)	92	(48)	670
Other investments (including derivative assets)	3,335	426	(1)	–	80	(215)	–	81	–	52	–	3,758
Derivative liabilities	(195)	(6)	–	–	–	–	–	–	–	–	–	(201)
Total financial investments, net of derivative liabilities	6,279	534	(45)	–	122	(434)	(67)	225	(28)	228	(51)	6,763
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(1,224)	(57)	(1)	–	–	2	94	(141)	–	–	–	(1,327)
Other financial liabilities	(2,021)	3	41	–	–	–	144	(218)	–	–	–	(2,051)
Total financial instruments at fair value	3,034	480	(5)	–	122	(432)	171	(134)	(28)	228	(51)	3,385
2012												
Loans	–	(46)	(42)	1,858	–	–	(12)	84	–	–	–	1,842
Equity securities and portfolio holdings in unit trusts	375	49	44	–	255	(98)	–	–	–	6	(63)	568
Debt securities	859	65	(3)	–	260	(228)	(73)	–	–	18	(169)	729
Other investments (including derivative assets)	3,277	250	(61)	–	482	(613)	–	–	–	–	–	3,335
Derivative liabilities	(218)	13	–	–	–	–	–	–	–	–	10	(195)
Total financial investments, net of derivative liabilities	4,293	331	(62)	1,858	997	(939)	(85)	84	–	24	(222)	6,279
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(911)	(20)	(47)	–	(153)	–	–	(93)	–	–	–	(1,224)
Other financial liabilities	–	41	46	(2,075)	–	–	73	(106)	–	–	–	(2,021)
Total financial instruments at fair value	3,382	352	(63)	(217)	844	(939)	(12)	(115)	–	24	(222)	3,034
Other assets at fair value												
2013												
Investment properties	10,554	441	(15)	–	1,110	(613)	–	–	–	–	–	11,477

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

Of the total net gains and losses in the income statement of £480 million (2012: £419 million), £415 million (2012: £126 million) relates to net unrealised gains relating to financial instruments still held at the end of the period, which can be analysed as follows:

	2013 £m	2012 £m
Equity securities	46	27
Debt securities	30	51
Other investments	397	48
Derivative liabilities	(8)	–
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(57)	–
Other financial liabilities	7	
Total	415	126

Valuation approach for level 3 fair valued assets and liabilities

Financial instruments at fair value

Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions eg market illiquidity. The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources when available, but overall the source of pricing is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The fair value estimates are made at a specific point in time, based upon available market information and judgments about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time the Group's entire holdings of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued. In some cases the disclosed value cannot be realised in immediate settlement of the financial instrument.

In accordance with the Group's risk management framework, the estimated fair value of derivative financial instruments valued internally using standard market practices are subject to assessment against external counterparties' valuations.

At 31 December 2013 the Group held £3,385 million (2012: £3,034 million), 2 per cent of the total fair valued financial assets net of fair valued financial liabilities (2012: 1 per cent), within level 3.

Included within these amounts were loans of £1,887 million at 31 December 2013 (2012: £1,842 million), measured at the loan outstanding balance, attached to REALIC acquired in 2012 and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,051 million at 31 December 2013 (2012: £2,021 million) was also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

Excluding the loans and funds withheld liability under REALIC's reinsurance arrangements as described above, which amounted to a net liability of £(164) million (2012: £(179) million), the level 3 fair valued financial assets net of financial liabilities were £3,549 million (2012: £3,213 million). Of this amount, a net liability of £(304) million (2012: net liability of £(213) million) were internally valued, representing 0.1 per cent of the total fair valued financial assets net of financial liabilities (2012: 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net liabilities were:

(a) Debt securities of £118 million (2012: £75 million), which were either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured).

(b) Private equity and venture investments of £878 million (2012: £904 million) which were valued internally based on management information available for these investments. These investments were principally held by consolidated investment funds which are managed on behalf of third parties.

(c) Liabilities of £(1,301) million (2012: £(1,199) million) for the net asset value attributable to external unit holders respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets.

(d) Other sundry individual financial investments of £1 million (2012: £7 million).

Of the internally valued net liability referred to above of £(304) million (2012: net liability of £(213) million):

(e) A net liability of £(380) million (2012: net liability of £(240) million) was held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments.
(f) A net asset of £nil (2012: £3 million) was held by the Group's unit-linked funds for which the investment return is wholly attributable to policyholders.
(g) A net asset of £76 million (2012: £24 million) was held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally was varied downwards by 10 per cent, the change in valuation would be £8 million (2012: £2 million), which would reduce shareholders' equity by this amount before tax. Of this amount, a decrease of £6 million (2012: an increase of £1 million) would pass through the income statement substantially as part of short-term fluctuations in investment returns outside of operating profit and a £2 million decrease (2012: a £3 million decrease) would be included as part of other comprehensive income, being unrealised movements on assets classified as available-for-sale.

Other assets at fair value – Investment properties

The investment properties of the Group are principally held by the UK insurance operations which are externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors (RICS) valuation standards. An 'income capitalisation' technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the Group's investment properties. As the comparisons are not with properties which are virtually identical to Group's investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.

e Transfers into and transfers out of levels

The Group's policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer.

During 2013, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to 2 of £471 million and transfers from level 2 to level 1 of £260 million. These transfers which relate to equity securities and debt securities arose to reflect the change in the observability of the inputs used in valuing these securities.

In addition, the transfers into and out of level 3 in 2013 were £228 million and £(51) million, respectively. These transfers were between levels 3 and 2 and primarily for equity securities and debt securities.

f Valuation processes applied by the Group

The Group's valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by Business Unit committees as part of the Group's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions.

C3.3 Debt securities

This note provides analysis of the Group's debt securities, including asset-backed securities and sovereign debt securities, by segment.

Debt securities are carried at fair value. The amounts included in the statement of financial position are analysed as follows, with further information relating to the credit quality of the Group's debt securities at 31 December 2013 provided in the notes below.

	2013 £m	**2012*** £m
Insurance operations:		
Asia[note (a)]	**18,554**	20,067
US[note (b)]	**30,292**	32,993
UK[note (c)]	**82,014**	84,008
Asset management operations	**2,045**	1,839
Total	**132,905**	138,907

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

In the tables below, with the exception of some mortgage-backed securities, Standard & Poor's (S&P) ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

a Asia insurance operations

	2013 £m				2012* £m
	With-profits business	Unit-linked assets	Other business	Total	Total
S&P – AAA	489	13	222	724	785
S&P – AA+ to AA-	2,584	432	1,717	4,733	5,523
S&P – A+ to A-	1,710	257	929	2,896	3,272
S&P – BBB+ to BBB-	1,349	516	852	2,717	1,906
S&P – Other	351	238	844	1,433	3,132
	6,483	1,456	4,564	12,503	14,618
Moody's – Aaa	1,076	218	434	1,728	1,389
Moody's – Aa1 to Aa3	128	31	17	176	271
Moody's – A1 to A3	104	22	51	177	147
Moody's – Baa1 to Baa3	238	207	127	572	375
Moody's – Other	30	13	33	76	112
	1,576	491	662	2,729	2,294
Fitch	415	131	182	728	533
Other	1,262	373	959	2,594	2,622
Total debt securities	9,736	2,451	6,367	18,554	20,067

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

In addition to the debt securities shown above, the assets held for sale on the consolidated statement of financial position at 31 December 2013 in respect of Japan life business included a debt securities balance of £387 million. Of this amount, £356 million were rated as AA+ to AA- and £29 million were rated A+ to A-.

The following table analyses debt securities of 'Other business' which are not externally rated by S&P, Moody's or Fitch.

	2013 £m	2012* £m
Government bonds	387	58
Corporate bonds rated as investment grade by local external ratings agencies	491	428
Structured deposits issued by banks which are rated, but specific deposits are not	1	–
Other	80	123
	959	609

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

b US insurance operations

i Overview

	2013 £m	2012 £m
Corporate and government security and commercial loans:		
Government	3,330	4,126
Publicly traded and SEC Rule 144A securities*	18,875	19,699
Non-SEC Rule 144A securities	3,395	3,542
Total	25,600	27,367
Residential mortgage-backed securities (RMBS)	1,760	2,400
Commercial mortgage-backed securities (CMBS)	2,339	2,639
Other debt securities	593	587
Total US debt securities†	30,292	32,993

* A 1990 SEC rule that facilitates the resale of privately placed securities under Rule 144A that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

† Debt securities for US operations included in the statement of financial position comprise:

	2013 £m	2012 £m
Available-for-sale	30,205	32,825
Securities held at fair value through profit and loss to back liabilities for funds withheld under reinsurance arrangement	87	168
	30,292	32,993

ii Valuation basis, presentation of gains and losses and securities in an unrealised loss position

Under IAS 39, unless categorised as 'held to maturity' or 'loans and receivables' debt securities are required to be fair valued. Where available, quoted market prices are used. However, where securities do not have an externally quoted price based on regular trades or where markets for the securities are no longer active as a result of market conditions, IAS 39 requires that valuation techniques be applied. IFRS 13 requires classification of the fair values applied by the Group into a three level hierarchy. At 31 December 2013, 0.1 per cent of Jackson's debt securities were classified as level 3 (31 December 2012: 0.1 per cent) comprising of fair values where there are significant inputs which are not based on observable market data.

Except for certain assets covering liabilities that are measured at fair value, the debt securities of the US insurance operations are classified as 'available-for-sale'. Unless impaired, fair value movements are recognised in other comprehensive income. Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

Movements in unrealised gains and losses

There was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £2,807 million to a net unrealised gain of £781 million as analysed in the table below. This decrease reflects the effects of rising long-term interest rates.

	2013 £m			2012 £m
		Changes in unrealised appreciation†	Foreign exchange translation	
		Reflected as part of movement in Other comprehensive income		
Assets fair valued at below book value				
Book value*	10,825			4,551
Unrealised (loss) gain	(849)	(714)	43	(178)
Fair value (as included in statement of financial position)	9,976			4,373
Assets fair valued at or above book value				
Book value*	18,599			25,467
Unrealised gain (loss)	1,630	(1,375)	20	2,985
Fair value (as included in statement of financial position)	20,229			28,452
Total				
Book value*	29,424			30,018
Net unrealised gain (loss)	781	(2,089)	63	2,807
Fair value (as included in statement of financial position)	30,205			32,825

* Book value represents cost/amortised cost of the debt securities.
† Translated at the average rate of US$1.5646: £1.00.

Debt securities classified as available-for-sale in an unrealised loss position

(a) Fair value of securities as a percentage of book value

The following table shows the fair value of the debt securities in a gross unrealised loss position for various percentages of book value:

	2013 £m		2012 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss
Between 90% and 100%	7,624	(310)	4,214	(112)
Between 80% and 90%	1,780	(331)	85	(13)
Below 80%	572	(208)	74	(53)
Total	9,976	(849)	4,373	(178)

(b) Unrealised losses by maturity of security

	2013 £m	2012 £m
1 year to 5 years	(5)	(1)
5 years to 10 years	(224)	(9)
More than 10 years	(558)	(91)
Mortgage-backed and other debt securities	(62)	(77)
Total	(849)	(178)

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

(c) Age analysis of unrealised losses for the periods indicated

The following table shows the age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

	2013 £m			2012 £m		
	Non-investment grade	Investment grade	Total	Non-investment grade	Investment grade	Total
Less than 6 months	(2)	(52)	(54)	(5)	(101)	(106)
6 months to 1 year	(12)	(329)	(341)	(1)	(1)	(2)
1 year to 2 years	(2)	(423)	(425)	(2)	–	(2)
2 years to 3 years	(1)	–	(1)	(1)	–	(1)
More than 3 years	(13)	(15)	(28)	(31)	(36)	(67)
Total	(30)	(819)	(849)	(40)	(138)	(178)

(d) Securities whose fair values were below 80 per cent of the book value

£208 million of the £849 million of gross unrealised losses as shown in the table (a) above at 31 December 2013 (31 December 2012: £53 million of the £178 million of gross unrealised losses) related to securities whose fair values were below 80 per cent of the book value. The analysis of the £208 million (31 December 2012: £53 million), by category of debt securities and by age analysis indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

	2013 £m		2012 £m	
Category analysis	Fair value	Unrealised loss	Fair value	Unrealised loss
Residential mortgage-backed securities:				
Prime (including agency)	–	–	5	(2)
Sub-prime	4	(1)	18	(8)
	4	(1)	23	(10)
Commercial mortgage-backed securities	16	(6)	10	(23)
Other asset-backed securities	9	(6)	41	(20)
Total structured securities	29	(13)	74	(53)
Government bonds	521	(188)	–	–
Corporates	22	(7)	–	–
Total	572	(208)	74	(53)

The following table shows the age analysis as at 31 December 2013, of the securities whose fair values were below 80 per cent of the book value:

	2013 £m		2012 £m	
Age analysis	Fair value	Unrealised loss	Fair value	Unrealised loss
Less than 3 months	93	(24)	7	(2)
3 months to 6 months	418	(159)	–	–
More than 6 months	61	(25)	67	(51)
	572	(208)	74	(53)

iii Ratings

The following table summarises the securities detailed above by rating using S&P, Moody's, Fitch and implicit ratings of mortgage-backed securities based on National Association of Insurance Commissioners (NAIC) valuations:

	2013 £m	2012 £m
S&P – AAA	132	187
S&P – AA+ to AA-	5,252	6,343
S&P – A+ to A-	7,728	7,728
S&P – BBB+ to BBB-	9,762	10,230
S&P – Other	941	1,173
	23,815	25,661
Moody's – Aaa	65	55
Moody's – Aa1 to Aa3	13	18
Moody's – A1 to A3	65	21
Moody's – Baa1 to Baa3	70	56
Moody's – Other	10	13
	223	163
Implicit ratings of MBS based on NAIC* valuations (see below)		
NAIC 1	2,774	2,934
NAIC 2	179	207
NAIC 3-6	87	321
	3,040	3,462
Fitch	159	184
Other†	3,055	3,523
Total debt securities	30,292	32,993

* The Securities Valuation Office of the NAIC classifies debt securities into six quality categories ranging from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5 and securities in or near default are designated Class 6.

† The amounts within 'Other' which are not rated by S&P, Moody's nor Fitch, nor are MBS securities using the revised regulatory ratings, have the following NAIC classifications:

	2013 £m	2012 £m
NAIC 1	1,165	1,453
NAIC 2	1,836	2,022
NAIC 3-6	54	48
	3,055	3,523

For some mortgage-backed securities within Jackson, the table above includes these securities using the regulatory ratings detail issued by the NAIC. These regulatory ratings levels were established by external third parties (PIMCO for residential mortgage-backed securities and BlackRock Solutions for commercial mortgage-backed securities).

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

c UK insurance operations

	2013 £m						
			Other funds and subsidiaries			UK insurance operations	
	Scottish Amicable Insurance Fund	PAC with-profits fund	Unit-linked assets	PRIL	Other annuity and long-term business	2013 Total £m	2012* Total £m
S&P – AAA	367	4,403	785	2,944	338	8,837	9,200
S&P – AA+ to AA-	502	5,421	1,202	3,161	404	10,690	9,688
S&P – A+ to A-	825	10,896	1,720	6,599	851	20,891	23,000
S&P – BBB+ to BBB-	819	9,972	1,679	4,017	638	17,125	17,720
S&P – Other	214	2,578	97	292	74	3,255	3,043
	2,727	33,270	5,483	17,013	2,305	60,798	62,651
Moody's – Aaa	93	1,544	229	395	72	2,333	8,446
Moody's – Aa1 to Aa3	105	2,525	1,107	2,179	504	6,420	1,420
Moody's – A1 to A3	49	847	55	994	132	2,077	927
Moody's – Baa1 to Baa3	41	702	93	331	47	1,214	1,385
Moody's – Other	10	125	–	4	1	140	307
	298	5,743	1,484	3,903	756	12,184	12,485
Fitch	18	349	60	166	18	611	527
Other	297	5,353	144	2,433	194	8,421	8,345
Total debt securities	3,340	44,715	7,171	23,515	3,273	82,014	84,008

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Where no external ratings are available, internal ratings produced by the Group's asset management operation, which are prepared on the Company's assessment of a comparable basis to external ratings, are used where possible. The £8,421 million total debt securities held at 31 December 2013 (2012: £8,345 million) which are not externally rated are either internally rated or unrated. These are analysed as follows:

	2013 £m	2012* £m
Internal ratings or unrated:		
AAA to A-	3,691	3,173
BBB to B-	3,456	3,810
Below B- or unrated	1,274	1,362
Total	8,421	8,345

The majority of unrated debt security investments were held in SAIF and the PAC with-profits fund and relate to convertible debt and other investments which are not covered by ratings analysts nor have an internal rating attributed to them. For the £2,627 million for PRIL and other annuity and long-term business investments for non-linked shareholder-backed business which are not externally rated, £605 million were internally rated AA+ to AA-, £948 million A+ to A-, £868 million BBB+ to BBB-, £65 million BB+ to BB- and £141 million were internally rated B+ and below or unrated.

d Asset management operations

The debt securities are all held by M&G (Prudential Capital).

	2013 £m	2012 £m
M&G		
AAA to A- by Standard & Poor's or Aaa to A3 rated by Moody's	1,690	1,529
Other	355	310
Total M&G (including Prudential Capital)	2,045	1,839

e Asset-backed securities

The Group's holdings in asset-backed securities (ABS), which comprise residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDO) funds and other asset-backed securities, at 31 December 2013 is as follows:

	2013 £m	2012 £m
Shareholder-backed operations (excluding assets held in unit-linked funds):		
Asia insurance operations note (i)	139	144
US insurance operations note (ii)	4,692	5,626
UK insurance operations (2013: 36% AAA, 23% AA) note (iii)	1,727	1,408
Other operations note (iv)	667	566
	7,225	7,744
With-profits operations:		
Asia insurance operations note (i)	200	241
UK insurance operations (2013: 60% AAA, 12% AA) note (iii)	5,765	5,850
	5,965	6,091
Total	13,190	13,835

Notes

(i) Asia insurance operations
The Asia insurance operations' exposure to asset-backed securities is primarily held by the with-profits operations. Of the £200 million, 53 per cent (2012: 63 per cent) are investment graded.

(ii) US insurance operations
US insurance operations' exposure to asset-backed securities at 31 December 2013 comprises:

	2013 £m	2012 £m
RMBS		
Sub-prime (2013: 10% AAA, 10% AA)	255	261
Alt-A (2013: 1% AA, 7% BBB)	270	323
Prime including agency (2013: 75% AA, 2% A)	1,235	1,816
CMBS (2013: 43% AAA, 22% AA)	2,339	2,639
CDO funds (2013: 25% AA, 19% A), including £nil exposure to sub-prime	46	44
Other ABS (2013: 25% AAA, 20% AA), including £69 million exposure to sub-prime	547	543
Total	4,692	5,626

(iii) UK insurance operations
The majority of holdings of the shareholder-backed business relates to the UK market and primarily relates to investments held by PRIL. Of the holdings of the with-profits operations, £1,490 million (2012: £1,697 million) relates to exposure to the US markets and with the remaining exposure being primarily to the UK market.

(iv) Asset management operations
Asset management operations' exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £667 million, 85 per cent (2012: 77 per cent) are graded AAA.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

f Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities at 31 December 2013:

Exposure to sovereign debts

	2013 £m		2012* £m	
	Shareholder-backed business	With-profits funds	Shareholder-backed business	With-profits funds
Italy	53	53	51	59
Spain	1	14	1	31
France	19	–	18	–
Germany	413	389	444	469
Other Europe (principally Belgium and Isle of Man)	45	45	50	41
Total Continental Europe	531	501	564	600
United Kingdom	3,516	2,432	3,432	2,306
Total Europe	4,047	2,933	3,996	2,906
United States†	3,045	4,026	3,725	3,547
Other, predominantly Asia	3,084	1,508	3,069	1,401
Total	10,176	8,467	10,790	7,854

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new accounting standards described in A2 and their consequential impact.
† The exposure to the United States sovereign debt comprises holdings of Jackson, the UK and Asia insurance operations.

The table above excludes assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the table above excludes the proportionate share of sovereign debt holdings of the Group's joint venture operations. As discussed in note A2 following the adoption of IFRS 11 these operations are accounted for using single line equity method in the balance sheet.

Exposure to bank debt securities

	Bank debt securities £m							
	Senior debt			Subordinated debt				
Shareholder-backed business	Covered	Senior	Total senior debt	Tier 2	Tier 1	Total subordinated debt	31 Dec 2013 Total	31 Dec 2012 Total
Portugal	–	45	45	–	–	–	45	37
Ireland	–	17	17	–	–	–	17	16
Italy	–	30	30	–	–	–	30	39
Spain	100	12	112	23	–	23	135	168
Austria	–	–	–	12	–	12	12	11
France	23	64	87	71	17	88	175	195
Germany	–	3	3	63	–	63	66	22
Netherlands	–	14	14	57	81	138	152	182
Total Continental Europe	123	185	308	226	98	324	632	670
United Kingdom	409	175	584	673	112	785	1,369	1,466
Total Europe	532	360	892	899	210	1,109	2,001	2,136
United States	–	1,688	1,688	456	19	475	2,163	2,243
Other, predominantly Asia	21	281	302	300	96	396	698	741
Total	553	2,329	2,882	1,655	325	1,980	4,862	5,120
With-profits funds								
Portugal	–	6	6	–	–	–	6	6
Ireland	10	–	10	–	–	–	10	6
Italy	15	67	82	–	–	–	82	75
Spain	136	13	149	–	–	–	149	186
France	12	168	180	57	–	57	237	157
Germany	–	24	24	–	–	–	24	–
Netherlands	–	208	208	7	–	7	215	138
Total Continental Europe	173	486	659	64	–	64	723	568
United Kingdom	598	442	1,040	635	20	655	1,695	1,904
Total Europe	771	928	1,699	699	20	719	2,418	2,472
United States	–	1,942	1,942	129	143	272	2,214	2,083
Other, predominantly Asia	108	638	746	174	182	356	1,102	655
Total	879	3,508	4,387	1,002	345	1,347	5,734	5,210

The table above excludes assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the table above excludes the proportionate share of sovereign debt holdings of the Group's joint venture operations. As discussed in note A2 following the adoption of IFRS 11 these operations are accounted for using a single line equity method in the balance sheet.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

C3.4 Loans portfolio

Loans are accounted for at amortised cost net of impairment except for:

- Certain mortgage loans which have been designated at fair value through profit and loss of the UK insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and
- Certain policy loans of the US insurance operations which are held to back liabilities for funds withheld under reinsurance arrangement and are also accounted on a fair value basis.

The amounts included in the statement of financial position are analysed as follows:

	2013 £m	2012* £m
Insurance operations:		
Asia[note (a)]	922	1,006
US[note (b)]	6,375	6,235
UK[note (c)]	4,173	4,303
Asset management operations		
M&G[note (d)]	1,096	1,199
Total	12,566	12,743

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

a Asia insurance operations

The loans of the Group's Asia insurance operations comprise:

	2013 £m	2012* £m
Mortgage loans†	57	43
Policy loans†	611	602
Other loans‡	254	361
Total Asia insurance operations loans	922	1,006

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.
† The mortgage and policy loans are secured by properties and life insurance policies respectively.
‡ The majority of the other loans are commercial loans held by the Malaysia operation and which are all investment graded by two local rating agencies.

b US insurance operations

The loans of the Group's US insurance operations comprise:

	2013 £m			2012 £m		
	Loans backing liabilities for funds withheld	Other loans	Total	Loans backing liabilities for funds withheld	Other loans	Total
Mortgage loans*	–	3,671	3,671	–	3,543	3,543
Policy loans†	1,887	817	2,704	1,842	850	2,692
Total US insurance operations loans	1,887	4,488	6,375	1,842	4,393	6,235

* All of the mortgage loans are commercial mortgage loans which are collateralised by properties. The property types are industrial, multi-family residential, suburban office, retail and hotel. The breakdown by property type is as follows:

	2013 %	2012 %
Industrial	28	29
Multi-family residential	30	25
Office	13	17
Retail	19	19
Hotels	9	10
Other	1	–
	100	100

† The policy loans are fully secured by individual life insurance policies or annuity policies. The purchase of REALIC in the second half of 2012 included policy loans which are accounted for at fair value through profit and loss to back liabilities for funds withheld under reinsurance. The policy loans are valued at £1,887 million at 31 December 2013 (2012: £1,842 million). All other policy loans are accounted for at amortised cost, less any impairment.

The US insurance operations' commercial mortgage loan portfolio does not include any single-family residential mortgage loans and is therefore not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The average loan size is £6.5 million (2012: £6.3 million). The portfolio has a current estimated average loan to value of 61 per cent (2012: 65 per cent).

At 31 December 2013, Jackson had mortgage loans with a carrying value of £47 million (2012: £78 million) where the contractual terms of the agreements had been restructured.

c UK insurance operations

The loans of the Group's UK insurance operations comprise:

	2013 £m	2012* £m
SAIF and PAC WPSF:		
Mortgage loans†	1,183	1,311
Policy loans	12	16
Other loans‡	1,629	1,712
Total SAIF and PAC WPSF loans	2,824	3,039
Shareholder-backed operations:		
Mortgage loans†	1,345	1,259
Other loans	4	5
Total loans of shareholder-backed operations	1,349	1,264
Total UK insurance operations loans	4,173	4,303

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.
† The mortgage loans are collateralised by properties. By carrying value, 84 per cent of the £1,345 million held for shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 30 per cent.
‡ Other loans held by the PAC with-profits fund are all commercial loans and comprise mainly syndicated loans.

d Asset management operations

The M&G loans relate to loans and receivables managed by Prudential Capital. These assets are generally secured but most have no external credit ratings. Internal ratings prepared by the Group's asset management operations, as part of the risk management process, are:

	2013 £m	2012 £m
Loans and receivables internal ratings:		
AAA	108	–
AA+ to AA-	28	–
BBB+ to BBB-	516	836
BB+ to BB-	174	339
B+ to B-	250	24
Other	20	–
Total M&G (including Prudential Capital) loans	1,096	1,199

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

C3.5 Financial instruments – additional information

a Market risk

i Liquidity analysis

Contractual maturities of financial liabilities

The following table sets out the contractual maturities for applicable classes of financial liabilities, excluding derivative liabilities and investment contracts that are separately presented. The financial liabilities are included in the column relating to the contractual maturities at the undiscounted cash flows (including contractual interest payments) due to be paid assuming conditions are consistent with those of year end.

	2013 £m								
	Total carrying value	1 year or less	After 1 year to 5 years	After 5 years to 10 years	After 10 years to 15 years	After 15 years to 20 years	Over 20 years	No stated maturity	Total
Financial liabilities									
Core structural borrowings of shareholder-financed operations[C6.1]	4,636	166	928	1,100	823	1,196	2,542	1,721	8,476
Operational borrowings attributable to shareholder-financed operations[C6.2]	2,152	1,790	375	–	–	–	–	–	2,165
Borrowings attributable to with-profits funds[C6.2]	895	118	406	211	48	12	70	189	1,054
Obligations under funding, securities lending and sale and repurchase agreements	2,074	2,074	–	–	–	–	–	–	2,074
Other liabilities	3,736	1,526	44	58	–	–	–	2,108	3,736
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	5,278	5,278	–	–	–	–	–	–	5,278
Other creditors	3,307	3,049	24	39	79	74	386	–	3,651
	22,078	14,001	1,777	1,408	950	1,282	2,998	4,018	26,434

	2012* £m								
	Total carrying value	1 year or less	After 1 year to 5 years	After 5 years to 10 years	After 10 years to 15 years	After 15 years to 20 years	Over 20 years	No stated maturity	Total
Financial liabilities									
Core structural borrowings of shareholder-financed operations[C6.1]	3,554	140	791	603	958	1,038	691	1,753	5,974
Operational borrowings attributable to shareholder-financed operations[C6.2]	2,245	1,708	558	–	–	–	–	–	2,266
Borrowings attributable to with-profits funds[C6.2]	968	115	542	199	71	12	73	129	1,141
Obligations under funding, securities lending and sale and repurchase agreements	2,381	2,381	–	–	–	–	–	–	2,381
Other liabilities	3,442	934	45	5	–	–	–	2,458	3,442
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	5,145	5,145	–	–	–	–	–	–	5,145
Other creditors	2,701	2,435	23	36	73	70	406	–	3,043
	20,436	12,858	1,959	843	1,102	1,120	1,170	4,340	23,392

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.:

Maturity analysis of derivatives

The following table shows the gross and net derivative positions together with a maturity profile of the net derivative position:

	Carrying value of net derivatives £m			Maturity profile of net derivative position £m				
	Derivative assets	Derivative liabilities	Net derivative position	1 year or less	After 1 year to 3 years	After 3 years to 5 years	After 5 years	Total
2013	**2,329**	**(1,689)**	**640**	**697**	**(12)**	**(9)**	**18**	**694**
2012*	3,862	(2,832)	1,030	1,022	(22)	(14)	(50)	936

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

The majority of derivative assets and liabilities have been included at fair value within the one year or less column, representing the basis on which they are managed (ie to manage principally asset or liability value exposures). The Group has no cash flow hedges and in general, contractual maturities are not considered essential for an understanding of the timing of the cash flows for these instruments. The only exception is certain identified interest rate swaps which are fully expected to be held until maturity solely for the purposes of matching cash flows on separately held assets and liabilities. For these instruments the undiscounted cash flows (including contractual interest amounts) due to be paid under the swap contract assuming conditions are consistent with those at year end are included in the column relating to the contractual maturity of the derivative.

The table below shows the maturity profile for investment contracts on an undiscounted basis to the nearest £ billion. This maturity profile has been based on the cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing EEV basis results.

	£bn							
	1 year or less	After 1 year to 5 years	After 5 years to 10 years	After 10 years to 15 years	After 15 years to 20 years	Over 20 years	Total undis-counted value	Total carrying value
2013	**5**	**18**	**17**	**13**	**10**	**9**	**72**	**56**
2012	4	16	15	11	8	10	64	52

Most investment contracts have options to surrender early, often subject to surrender or other penalties. Therefore, most contracts can be said to have a contractual maturity of less than one year, but in reality the additional charges and term of the contracts means these are unlikely to be exercised in practice and the more useful information is to present information on expected payment.

The maturity profile above excludes certain corporate unit-linked business with gross policyholder liabilities of £13 billion (2012: £12 billion) which have no stated maturity but which are repayable on demand.

This table has been prepared on an undiscounted basis and accordingly the amounts shown for life assurance investment contracts differ from those disclosed on the statement of financial position. Durations of long-term business contracts, covering insurance and investment contracts, on a discounted basis are included in section C4.

The vast majority of the Group's financial assets are held to back the Group's policyholder liabilities. Although asset/liability matching is an important component of managing policyholder liabilities (both those classified as insurance and those classified as investments), this profile is mainly relevant for managing market risk rather than liquidity risk. Within each business unit this asset/liability matching is performed on a portfolio-by-portfolio basis.

In terms of liquidity risk a large proportion of the policyholder liabilities contain discretionary surrender values or surrender charges, meaning that many of the Group's liabilities are expected to be held for the long term. Much of the Group's investment portfolios are in marketable securities, which can therefore be converted quickly to liquid assets.

For the reasons above an analysis of the Group's assets by contractual maturity is not considered appropriate to evaluate the nature and extent of the Group's liquidity risk.

ii Market and other financial risks

The Group's maximum exposure to credit risk of financial instruments before any allowance for collateral or allocation of losses to policyholders is represented by the carrying value of financial instruments on the balance sheet that have exposures to credit risk comprising cash and cash equivalents, deposits, debt securities, loans and derivative assets, and other debtors, the carrying value of which are disclosed at the start of this note and note (b) below for derivative assets. The collateral in place in relation to derivatives is described in note (c) below. Notes C3.4, describe the security for these loans held by the Group, as disclosed at the start of this note.

Of the total loans and receivables held, £14 million (2012: £25 million) are past their due date but have not been impaired. Of the total past due but not impaired, £9 million is less than one year past their due date (2012: £18 million). The Group expects full recovery of these loans and receivables.

No further analysis has been provided of the element of loans and receivables that was neither past due nor impaired for the total portfolio on the grounds of immateriality of the difference between the neither past due nor impaired elements and the total portfolio.

Financial assets that would have been past due or impaired had the terms not been renegotiated amounted to £59 million (2012: £86 million).

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

In addition, during the year the Group took possession of £nil (2012: £16 million) of other collateral held as security, which mainly consists of assets that could be readily converted into cash.

Further details of collateral and pledges are provided in note (c) below.

iii Foreign exchange risk

As at 31 December 2013, the Group held 20 per cent (2012: 19 per cent) and 7 per cent (2012: 7 per cent) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency of the relevant business unit.

Of these financial assets, 58 per cent (2012: 56 per cent) are held by the PAC with-profits fund, allowing the fund to obtain exposure to foreign equity markets.

Of these financial liabilities, 28 per cent (2012: 28 per cent) are held by the PAC with-profits fund, mainly relating to foreign currency borrowings.

The exchange risks inherent in these exposures are mitigated through the use of derivatives, mainly forward currency contracts (note (b) below).

The amount of exchange loss recognised in the income statement in 2013, except for those arising on financial instruments measured at fair value through profit and loss, is £284 million (2012: £213 million loss). This constitutes £1 million gain (2012: £1 million loss) on Medium Term Notes liabilities and £285 million of net loss (2012: £212 million net loss), mainly arising on investments of the PAC with-profits fund. The gains/losses on Medium Term Notes liabilities are fully offset by value movements on cross-currency swaps, which are measured at fair value through profit and loss.

b Derivatives and hedging

Derivatives

The Group enters into a variety of exchange traded and over-the-counter derivative financial instruments, including futures, options, forward currency contracts and swaps such as interest rate swaps, cross-currency swaps, swaptions and credit default swaps.

All over-the-counter derivative transactions, with the exception of some Asia transactions, are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual Group entities and relevant counterparties in place under each of these market master agreements.

The total fair value balances of derivative assets and liabilities as at 31 December 2013 were as follows:

	2013 £m					
	Asia insurance operations	US insurance operations	UK insurance operations	Asset management	Unallocated to a segment	Group total
Derivative assets	41	766	1,472	47	3	2,329
Derivative liabilities	(58)	(515)	(804)	(112)	(200)	(1,689)
	(17)	251	668	(65)	(197)	640

	2012* £m					
	Asia insurance operations	US insurance operations	UK insurance operations	Asset management	Unallocated to a segment	Group total
Derivative assets	927	1,546	1,349	38	2	3,862
Derivative liabilities	(837)	(645)	(1,010)	(150)	(190)	(2,832)
	90	901	339	(112)	(188)	1,030

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

The above derivative assets are included in 'other investments' in the statement of financial position and are used for efficient portfolio management to obtain cost effective and efficient management of exposure to various markets in accordance with the Group's investment strategies and to manage exposure to interest rate, currency, credit and other business risks. The Group also uses interest rate derivatives to reduce exposure to interest rate volatility. In particular:

- UK with-profits funds use derivatives for efficient portfolio management or reduction in investment risks. For UK annuity business derivatives are used to assist with asset and liability cash flow matching;
- US operations and some of the UK operations hold large amounts of interest-rate sensitive investments that contain credit risks on which a certain level of defaults is expected. These businesses have purchased some swaptions to manage the default risk on certain underlying assets and hence reduce the amount of regulatory capital held to support the assets; and
- Some products, especially in the US, have guarantee features linked to equity indexes. A mismatch between guaranteed product liabilities and the performance of the underlying assets, exposes the Group to equity index risk. In order to mitigate this risk, the relevant business units purchase swaptions, equity options and futures to better match asset performance with liabilities under equity-indexed products.

Hedging

The Group has formally assessed and documented the effectiveness of the following hedges under IAS 39.

Fair value hedges

The Group had previously designated as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of certain of the Group's operational borrowings. All of these hedges were terminated by January 2013. The fair value of the derivatives designated as fair value hedges above at 31 December 2012 was an asset of less than £1 million.

Movements in the fair value of the hedging instruments of a net gain of £0.3 million (2012: net loss of £3 million) and the hedged items of a net loss of £0.3 million (2012: net gain of £3 million) are recorded in the income statement in respect of these fair value hedges.

Net investment hedges

The Group has designated perpetual subordinated capital securities totalling US$3.55 billion (2012: US$2.85 billion) as a net investment hedge to hedge the currency risks related to the net investment in Jackson. The carrying value of the subordinated capital securities was £2,133 million as at 31 December 2013 (2012: £1,746 million). The foreign exchange gain of £46 million (2012: loss of £81 million) on translation of the borrowings to pounds sterling at the statement of financial position date is recognised in the translation reserve in shareholders' equity. This net investment hedge was 100 per cent effective.

The Group has no cash flow hedges in place.

c Derecognition, collateral and offsetting

Securities lending and reverse repurchase agreements

The Group has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be received as collateral by the agreements depend on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Group's consolidated statement of financial position, rather they are retained within the appropriate investment classification. Collateral typically consists of cash, debt securities, equity securities and letters of credit.

At 31 December 2013, the Group had lent £3,791 million (2012: £3,015 million) of securities of which £2,910 million (2012: £2,047 million) was lent by the PAC with-profits fund and held collateral under such agreements of £3,930 million (2012: £3,137 million) of which £3,012 million (2012: £2,138 million) was held by the PAC with-profits fund.

At 31 December 2013, the Group had entered into reverse repurchase transactions under which it purchased securities and had taken on the obligation to resell the securities. The fair value of the collateral held in respect of these transactions was £9,931 million (2012: £8,454 million).

In addition, at 31 December 2013, the Group had entered into repurchase transactions for which the fair value of the collateral pledged was cash of £17 million and securities of £524 million (2012: securities pledged of £100 million).

Collateral and pledges under derivative transactions

At 31 December 2013, the Group had pledged £780 million (2012: £754 million) for liabilities and held collateral of £1,432 million (2012: £1,964 million) in respect of over-the-counter derivative transactions.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and repurchase agreements.

C: Balance sheet notes continued

C3: Assets and liabilities – Classification and Measurement continued

Offsetting assets and liabilities

The Group's derivative instruments, repurchase agreements and securities lending agreements are subject to master netting arrangements and collateral arrangements. A master netting arrangement with a counterparty creates a right of offset for amounts due to and due from that same counterparty that is enforceable in the event of a default or bankruptcy. The Group recognises amounts subject to master netting arrangements on a gross basis within the consolidated balance sheets.

The following tables present the gross and net information about the Group's financial instruments subject to master netting arrangements:

	31 Dec 2013 £m				
	Gross amount presented in the consolidated financial position note (i)	Gross amounts not offset in the consolidated statement of financial position			
		Financial instruments note (ii)	Cash collateral	Securities collateral note (iii)	Net amount
Financial assets:					
Derivative assets	2,136	(832)	(555)	(631)	118
Reverse repurchase agreements	9,931	–	–	(9,931)	–
	12,067	(832)	(555)	(10,562)	118
Financial liabilities:					
Derivative liabilities	(1,479)	832	222	333	(92)
Securities lending	(1,242)	–	1,242	–	–
Repurchase agreements	(541)	–	17	524	–
Total financial liabilities	(3,262)	832	1,481	857	(92)

	31 Dec 2012 £m				
	Gross amount presented in the consolidated financial position note (i)	Gross amounts not offset in the consolidated statement of financial position			
		Financial instruments note (ii)	Cash collateral	Securities collateral note (iii)	Net amount
Financial assets:					
Derivative assets	3,683	(1,868)	(536)	(989)	290
Reverse repurchase agreements	8,454	–	–	(8,454)	–
	12,137	(1,868)	(536)	(9,443)	290
Financial liabilities:					
Derivative liabilities	(2,552)	1,868	205	70	(409)
Securities lending	(2,017)	–	2,017	–	–
Repurchase agreements	(100)	–	–	100	–
Total financial liabilities	(4,669)	1,868	2,222	170	(409)

Notes

(i) The Group has not offset any of the amounts presented in the consolidated statement of financial position.

(ii) Represents the amount that could be offset under master netting or similar arrangements where Group does not satisfy the full criteria to offset on the consolidated statement of financial position.

(iii) Excludes initial margin amounts for exchange-traded derivatives.

In the tables above, the amounts of assets or liabilities presented in the consolidated statement of financial position are offset first by financial instruments that have the right of offset under master netting or similar arrangements with any remaining amount reduced by the amount of cash and securities collateral. The actual amount of collateral may be greater than amounts presented in the tables.

d Impairment of financial assets

In accordance with the Group's accounting policy set out in note A3(j), impairment reviews were performed for available-for-sale securities and loans and receivables. In addition, impairment reviews were undertaken for the reinsurers' share of insurance contract liabilities.

During the year ended 31 December 2013, net impairment reversals of £17 million (2012: losses of £(50) million) were recognised for available-for-sale securities and loans and receivables analysed as shown in the attached table.

	2013 £m	2012 £m
Available-for-sale debt securities held by Jackson	(8)	(37)
Loans and receivables*	25	(13)
Net credit (charge) for impairment net of reversals	17	(50)

* Relates to loans held by the UK with-profits fund and mortgage loans held by Jackson.

Impairment recognised on available-for-sale securities amounted to £(8) million (2012: £(37) million) arising from:

	2013 £m	2012 £m
Residential mortgage-backed securities	(3)	(8)
Public fixed income	–	(2)
Other	(5)	(27)
	(8)	(37)

The impairment recorded on the residential mortgage-backed securities was primarily due to reduced cash flow expectations on such securities that are collateralised by diversified pools of primarily below investment grade securities. Of the impaired losses of £8 million (2012: £37 million), the top five individual corporate issuers made up 57 per cent (2012: 74 per cent), reflecting a deteriorating business outlook of the companies concerned. The impairment losses have been recorded in 'investment return' in the income statement.

Jackson's portfolio of debt securities is managed proactively with credit analysts closely monitoring and reporting on the credit quality of its holdings. Jackson continues to review its investments on a case-by-case basis to determine whether any decline in fair value represents an impairment. In addition, investments in structured securities are subject to a rigorous review of their future estimated cash flows including expected and stress case scenarios to identify potential shortfalls in contractual payments (both interest and principal). Impairment charges are recorded on structured securities when the Company forecasts a contractual payment shortfall. Situations where such a shortfall would not lead to a recognition of a loss are rare. However, some structured securities do not have a single determined set of future cash flows and instead, there can be a reasonable range of estimates that could potentially emerge. With this variability, there could be instances where the projected cash flow shortfall under management's base case set of assumptions is so minor that relatively small and justifiable changes to the base case assumptions would eliminate the need for an impairment loss to be recognised. The impairment loss reflects the difference between the fair value and book value.

In 2013, the Group realised gross losses on sales of available-for-sale securities of £22 million (2012: £44 million) with 72 per cent (2012: 64 per cent) of these losses related to the disposal of fixed maturity securities of the top 10 individual issuers, which were disposed of as part of risk reduction programmes intended to limit future credit loss exposure. Of the £22 million (2012: £ 44 million), £5 million (2012: £23 million) relates to losses on sales of impaired and deteriorating securities.

The effect of those reasonably likely changes in the key assumptions that underpin the assessment of whether impairment has taken place depends on the factors described in note A3(j). A key indicator of whether such impairment may arise in future, and the potential amounts at risk, is the profile of gross unrealised losses for fixed maturity securities accounted for on an available-for-sale basis by reference to the time periods by which the securities have been held continuously in an unrealised loss position and by reference to the maturity date of the securities concerned.

For 2013, the amount of gross unrealised losses for fixed maturity securities classified as available-for-sale under IFRS in an unrealised loss position was £849 million (2012: £178 million). Notes B1.2 and C3.3 provide further details on the impairment charges and unrealised losses of Jackson's available-for-sale securities.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds

The note provides information of policyholder liabilities and unallocated surplus of with-profit funds held on the Group's statement of financial position:

C4.1 Movement and duration of liabilities

C4.1(a) Group overview

i Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

	Insurance operations £m			
	Asia note C4.1(b)	US note C4.1(c)	UK note C4.1(d)	Total
At 1 January 2012	30,912	69,189	136,189	236,290
Comprising:				
*Policyholder liabilities on the consolidated statement of financial position**	28,110	69,189	127,024	224,323
Unallocated surplus of with-profits funds on the consolidated statement of financial position	50	–	9,165	9,215
Group's share of policyholder liabilities of joint ventures§	2,752	–	–	2,752
Net flows:				
Premiums	5,620	14,907	8,340	28,867
Surrenders	(2,541)	(4,356)	(4,785)	(11,682)
Maturities/Deaths	(658)	(954)	(8,009)	(9,621)
Net flows	2,421	9,597	(4,454)	7,564
Shareholders' transfers post tax	(31)	–	(205)	(236)
Investment-related items and other movements	2,178	4,241	13,006	19,425
Foreign exchange translation differences	(816)	(3,678)	(98)	(4,592)
Acquisition of REALIC[note D1]	–	12,912	–	12,912
As at 31 December 2012/1 January 2013	34,664	92,261	144,438	271,363
Comprising:				
*Policyholder liabilities on the consolidated statement of financial position**	31,501	92,261	133,912	257,674
Unallocated surplus of with-profits funds on the consolidated statement of financial position	63	–	10,526	10,589
Group's share of policyholder liabilities of joint ventures§	3,100	–	–	3,100
Reclassification of Japan life business as held for sale†	(1,026)	–	–	(1,026)
Net flows:				
Premiums	6,555	15,951	7,378	29,884
Surrenders	(2,730)	(5,087)	(4,582)	(12,399)
Maturities/Deaths	(997)	(1,229)	(8,121)	(10,347)
Net flows	2,828	9,635	(5,325)	7,138
Shareholders' transfers post tax	(38)	–	(192)	(230)
Investment-related items and other movements	462	8,219	7,812	16,493
Foreign exchange translation differences	(2,231)	(2,704)	(117)	(5,052)
Acquisition of Thanachart Life[note D1]	487	–	–	487
At 31 December 2013	35,146	107,411	146,616	289,173
Comprising:				
*Policyholder liabilities on the consolidated statement of financial position**	31,910	107,411	134,632	273,953
Unallocated surplus of with-profits funds on the consolidated statement of financial position	77	–	11,984	12,061
Group's share of policyholder liabilities of joint ventures§	3,159	–	–	3,159
Average policyholder liability balances‡				
2013	34,423	99,836	134,272	268,531
2012	32,732	77,497	130,468	240,697

* The 2012 comparative results in the consolidated statement of financial position have been adjusted retrospectively from those previously published for the application of the new accounting standards described in note A2.

† The reclassification of Japan life business as held for sale reflects the value of policyholder liabilities held at 1 January 2013 following its reclassification during 2013 as held for sale. No other amounts are shown within the 2013 analysis above in respect of Japan. The comparatives include the Japan life business. If Japan life business had been excluded from the 2012 amount, the average policyholder liability balance for 2012 would have been £31,616 million for Asia.

‡ Averages have been based on opening and closing balances and adjusted for acquisitions and disposals in the year and exclude unallocated surplus of with-profits funds and adjusted for corporate transactions in the year.

§ The Group's investment in joint ventures are accounted for on the equity method in the Group's balance sheet. The Group's share of the policyholder liabilities as shown above relate to the joint venture life business in China, India and of the Takaful business in Malaysia.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the year. The items above are shown gross of reinsurance.

The analysis includes the impact of premiums, claims and investment movements on policyholders' liabilities. The impact does not represent premiums, claims and investment movements as reported in the income statement. For example, the premiums shown above will exclude any deductions for fees/charges and claims represent the policyholder liabilities provision released rather than the claim amount paid to the policyholder.

ii Analysis of movements in policyholder liabilities for shareholder-backed business

	2012* £m			
Shareholder-backed business	**Asia**	**US**	**UK**	**Total**
At 1 January	18,269	69,189	46,048	133,506
Net flows:				
Premiums	4,141	14,907	3,801	22,849
Surrenders	(1,933)	(4,356)	(2,585)	(8,874)
Maturities/Deaths	(226)	(954)	(2,345)	(3,525)
Net flows[note (a)]	1,982	9,597	(1,129)	10,450
Investment-related items and other movements	1,539	4,241	4,586	10,366
Acquisition of subsidiaries	–	12,912	–	12,912
Foreign exchange translation differences	(577)	(3,678)	–	(4,255)
At 31 December	21,213	92,261	49,505	162,979
Comprising:				
Policyholder liabilities on the consolidated statement of financial position	18,113	92,261	49,505	159,879
Group's share of policyholder liabilities relating to joint ventures	3,100	–	–	3,100

	2013 £m			
Shareholder-backed business	**Asia**	**US**	**UK**	**Total**
At 1 January	21,213	92,261	49,505	162,979
Reclassification of Japan life business as held for sale[note (b)]	(1,026)	–	–	(1,026)
Premiums	4,728	15,951	3,628	24,307
Surrenders	(2,016)	(5,087)	(2,320)	(9,423)
Maturities/Deaths	(363)	(1,229)	(2,346)	(3,938)
Net flows[note (a)]	2,349	9,635	(1,038)	10,946
Investment-related items and other movements	622	8,219	2,312	11,153
Acquisition of subsidiaries	487	–	–	487
Foreign exchange translation differences	(1,714)	(2,704)	–	(4,418)
At 31 December	21,931	107,411	50,779	180,121
Comprising:				
Policyholder liabilities on the consolidated statement of financial position	18,772	107,411	50,779	176,962
Group's share of policyholder liabilities relating to joint ventures	3,159	–	–	3,159

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(a) Including net flows of the Group's insurance joint ventures.

(b) The reclassification of Japan life business as held for sale reflects the value of policyholder liabilities held at 1 January 2013 following its reclassification during 2013 as held for sale. No other amounts are shown within the 2013 analysis above in respect of Japan.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

iii Movement in insurance contract liabilities and unallocated surplus of with-profits funds

Further analysis of the movement in the year of the Group's insurance contract liabilities, gross and reinsurance share, and unallocated surplus of with-profits funds is provided below:

	Insurance contract liabilities*		Unallocated surplus of with profits funds
	Gross £m	Reinsurers' share £m	£m
At 1 January 2012	180,363	1,486	9,215
Income and expense included in the income statement and other comprehensive income	16,561	–	1,381
Acquisition of REALIC	12,912	4,810	–
Other movements in the year	–	(58)	–
Foreign exchange translation differences	(4,352)	(162)	(7)
At 31 December 2012/1 January 2013	**205,484**	**6,076**	**10,589**
Reclassification of Japan life business as held for sale	**(1,026)**	**–**	**–**
Income and expense included in the income statement and other comprehensive income	**18,133**	**–**	**1,507**
Acquisition of Thanachart Life	**487**	**–**	**–**
Other movements in the year	**–**	**56**	**–**
Foreign exchange translation differences	**(4,893)**	**(114)**	**(35)**
At 31 December 2013	**218,185**	**6,018**	**12,061**

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

iv Reinsurers' share of insurance contract liabilities

	2013 £m				2012* £m
	Asia	US	UK	Total	Total
Insurance contract liabilities	**381**	**5,406**	**231**	**6,018**	6,076
Claims outstanding	**141**	**659**	**20**	**820**	778
	522	**6,065**	**251**	**6,838**	6,854

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

The Group cedes certain business to other insurance companies. Although the ceding of insurance does not relieve the Group from its liability to its policyholders, the Group participates in such agreements for the purpose of managing its loss exposure. The Group evaluates the financial condition of its reinsurers and monitors concentration of credit risk from similar geographic regions, activities or economic characteristics of the reinsurers to minimise its exposure from reinsurer insolvencies. Of the reinsurers' share of insurance contract liabilities balance of £6,838 million at 31 December 2013 (2012: £6,854 million), 96 per cent (2012: 97 per cent) were ceded by the Group's UK and US operations, of which 93 per cent (2012: 92 per cent) of the balance were from reinsurers with Standard & Poor's rating A- and above.

The reinsurance asset for Jackson as shown in the table above primarily relates to certain fully collateralised former REALIC business retained by Swiss Re through 100 per cent reinsurance agreements. Jackson acquired the REALIC business in 2012 (see note D1(b)). Apart from the reinsurance acquired through the purchase of REALIC, the principal reinsurance ceded by Jackson outside the Group is on term life insurance, direct and assumed accident and health business and GMIB variable annuity guarantees. Net commissions received on ceded business and claims incurred ceded to external reinsurers totalled £37 million and £278 million respectively during 2013 (2012: £24 million and £123 million respectively). There were no deferred gains or losses on reinsurance contracts in either 2013 or 2012.

The Group's Asia and UK businesses do not cede significant amounts of business outside the Group. During 2013, the Group's UK insurance business wrote a longevity swap on certain aspects of the UK's annuity back-book liabilities. This resulted in a one-off benefit of £27 million to IFRS profit before tax. The gains and losses recognised in profit and loss for the other reinsurance contracts written in the year were immaterial.

C4.1(b) Asia insurance operations

i Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of Asia insurance operations from the beginning of the year to the end of the year is as follows:

	With-profits business £m	Unit-linked liabilities £m	Other business £m	Total £m
At 1 January 2012	12,643	12,015	6,254	30,912
Comprising:				
*Policyholder liabilities on the consolidated statement of financial position**	12,593	10,101	5,416	28,110
Unallocated surplus of with-profits funds on the consolidated statement of financial position	50	–	–	50
Group's share of policyholder liabilities relating to joint ventures‡	–	1,914	838	2,752
Premiums:				
New business	216	1,336	636	2,188
In-force	1,263	1,292	877	3,432
	1,479	2,628	1,513	5,620
Surrenders[note (c)]	(608)	(1,675)	(258)	(2,541)
Maturities/Deaths	(432)	(30)	(196)	(658)
Net flows[note (b)]	439	923	1,059	2,421
Shareholders' transfers post tax	(31)	–	–	(31)
Investment-related items and other movements	639	1,451	88	2,178
Foreign exchange translation differences[note (a)]	(239)	(361)	(216)	(816)
At 31 December 2012 / 1 January 2013	13,451	14,028	7,185	34,664
Comprising:				
*Policyholder liabilities on the consolidated statement of financial position**	13,388	11,969	6,144	31,501
Unallocated surplus of with-profits funds on the consolidated statement of financial position	63	–	–	63
Group's share of policyholder liabilities relating to joint ventures‡	–	2,059	1,041	3,100
Reclassification of Japan life business as held for sale§	–	(366)	(660)	(1,026)
Premiums:				
New business	242	1,519	902	2,663
In-force	1,585	1,301	1,006	3,892
	1,827	2,820	1,908	6,555
Surrenders[note (c)]	(714)	(1,799)	(217)	(2,730)
Maturities/Deaths	(634)	(46)	(317)	(997)
Net flows[note (b)]	479	975	1,374	2,828
Shareholders' transfers post tax	(38)	–	–	(38)
Investment-related items and other movements[note (d)]	(160)	369	253	462
Acquisition of Thanachart life	–	–	487	487
Foreign exchange translation differences[note (a)]	(517)	(1,241)	(473)	(2,231)
At 31 December 2013	13,215	13,765	8,166	35,146
Comprising:				
*Policyholder liabilities on the consolidated statement of financial position**	13,138	11,918	6,854	31,910
Unallocated surplus of with-profits funds on the consolidated statement of financial position	77	–	–	77
Group's share of policyholder liabilities relating to joint ventures‡	–	1,847	1,312	3,159
Average policyholder liability balances†				
2013	13,263	13,714	7,446	34,423
2012	12,990	13,022	6,720	32,732

* The 2012 comparative results in the consolidated statement of financial position have been adjusted retrospectively from those previously published for the application of the new accounting standards described in note A2.

† Averages have been based on opening and closing balances and adjusted for acquisitions and disposals in the year and exclude unallocated surplus of with-profits funds.

‡ The Group's investment in joint ventures are accounted for on an equity method and the Group's share of the policyholder liabilities as shown above relate to the joint venture life business in China, India and of the Takaful business in Malaysia.

§ The reclassification of Japan life business as held for sale reflects the value of policyholder liabilities held at 1 January 2013 following its reclassification during 2013 as held for sale. No other amounts are shown within the 2013 analysis above in respect of Japan. The 2012 comparatives include the Japan life business. If Japan life business had been excluded from the 2012 amount, the average policyholder liability balance for 2012 would have been £31,616 million in total allocated £12,990 million, £12,648 million and £5,978 million for its with-profits business, unit-linked business and other business respectively.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

Notes

(a) Movements in the year have been translated at the average exchange rates for the year ended 31 December 2013. The closing balance has been translated at the closing spot rates as at 31 December 2013. Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows have increased by £407 million to £2,828 million in 2013 compared with £2,421 million in 2012 reflecting increased flows from new business and growth in the in-force books.

(c) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities after the removal of Japan) was 10.0 per cent in 2013, lower than the 10.6 per cent recorded in 2012. Maturities/deaths have increased from £658 million in 2012 to £997 million in 2013, primarily as a result of an increased number of endowment products within Hong Kong, Singapore and Thailand reaching their maturity point.

(d) Investment-related items and other movements for 2013 principally represents unrealised losses on bonds, following the rise in bond yields within the with-profits funds and positive investment gains from the Asia equity market in the unit-linked and other business.

ii Duration of liabilities

The table below shows the carrying value of policyholder liabilities. The table below also shows the maturity profile of the cash flows on a discounted basis for 2013 and 2012, taking account of expected future premiums and investment returns:

	2013 £m	**2012*** £m
Policyholder liabilities	**31,910**	31,501
	%	**%**
Expected maturity:		
0 to 5 years	**23**	22
5 to 10 years	**20**	19
10 to 15 years	**16**	16
15 to 20 years	**12**	13
20 to 25 years	**9**	10
Over 25 years	**20**	20

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

iii Summary policyholder liabilities (net of reinsurance) and unallocated surplus

At 31 December 2013, the summary policyholder liabilities and unallocated surplus for Asia operations of £32.0 billion (2012: £31.6 billion), net of reinsurance of £251 million (2012: £170 million), excluding joint ventures, comprised the following:

	2013 £m	**2012*** £m
Hong Kong	**8,655**	8,610
Indonesia	**1,824**	2,110
Korea	**2,450**	2,131
Malaysia	**3,434**	3,226
Singapore	**10,886**	10,731
Taiwan	**2,236**	1,931
Other countries	**2,251**	2,655
Total Asia operations	**31,736**	31,394

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

C4.1(c) US insurance operations

i Analysis of movements in policyholder liabilities

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the year to the end of the year is as follows:

US insurance operations	Variable annuity separate account liabilities £m	Fixed annuity, GIC and other business £m	Total £m
At 1 January 2012	37,833	31,356	69,189
Premiums	10,361	4,546	14,907
Surrenders	(2,149)	(2,207)	(4,356)
Maturities/Deaths	(404)	(550)	(954)
Net flows[note (b)]	7,808	1,789	9,597
Transfers from general to separate account	1,577	(1,577)	–
Investment-related items and other movements	4,014	227	4,241
Foreign exchange translation differences[note (a)]	(1,998)	(1,680)	(3,678)
Acquisition of REALIC[note (d)]	64	12,848	12,912
At 31 December 2012/1 January 2013	49,298	42,963	92,261
Premiums	11,377	4,574	15,951
Surrenders	(2,906)	(2,181)	(5,087)
Maturities/Deaths	(485)	(744)	(1,229)
Net flows[note (b)]	7,986	1,649	9,635
Transfers from general to separate account	1,603	(1,603)	–
Investment-related items and other movements[note (c)]	8,725	(506)	8,219
Foreign exchange translation differences[note (a)]	(1,931)	(773)	(2,704)
At 31 December 2013	65,681	41,730	107,411
Average policyholder liability balances*			
2013	57,489	42,347	99,836
2012	43,549	33,948	77,497

* Averages have been based on opening and closing balances, and adjusted for acquisitions and disposals in the year.

Notes

(a) Movements in the year have been translated at an average rate of US$1.56/£1.00 (2012: US$1.58/£1.00). The closing balances have been translated at closing rate of US$1.66/£1.00 (2012: US$1.63/£1.00). Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows for the year were £9,635 million compared with £9,597 million in 2012. Gross inflows increased by 7 per cent primarily reflecting increased variable annuity new business volume.

(c) Positive investment-related items and other movements in variable annuity separate account liabilities of £8,725 million for 2013 primarily reflects the increase in the US equity market during the year. Fixed annuity, GIC and other business investment and other movements primarily reflects the reduction in guarantee reserves (reflecting the impact of higher equity values and higher interest rates on these reserves), which has more than offset the increase in general account reserves which arise from interest credited to policyholder accounts in the year.

(d) The amounts shown for the acquisition of REALIC represents the liabilities, before reduction for reinsurance ceded, acquired at the date of acquisition.

ii Duration of liabilities

The table below shows the carrying value of policyholder liabilities. The table below also shows the maturity profile of the cash flows on a discounted basis for 2013 and 2012:

	2013 £m			2012 £m		
	Fixed annuity and other business (including GICs and similar contracts)	Variable annuity	Total	Fixed annuity and other business (including GICs and similar contracts)	Variable annuity	Total
Policyholder liabilities	41,730	65,681	107,411	42,963	49,298	92,261
	2013 %			2012 %		
Expected maturity:						
0 to 5 years	49	48	48	45	46	46
5 to 10 years	27	31	30	27	31	29
10 to 15 years	11	13	12	12	13	13
15 to 20 years	6	5	5	7	6	6
20 to 25 years	4	2	3	5	2	3
Over 25 years	3	1	2	4	2	3

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

C4.1(d) UK insurance operations

i Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK insurance operations from the beginning of the year to the end of the year is as follows:

		Shareholder-backed funds and subsidiaries		
	SAIF and PAC with-profits sub-fund £m	**Unit-linked liabilities** £m	**Annuity and other long-term business** £m	**Total** £m
At 1 January 2012	90,141	21,281	24,767	136,189
Comprising:				
Policyholder liabilities	80,976	21,281	24,767	127,024
Unallocated surplus of with-profits funds	9,165	–	–	9,165
Premiums	4,539	1,775	2,026	8,340
Surrenders	(2,200)	(2,378)	(207)	(4,785)
Maturities/Deaths	(5,664)	(658)	(1,687)	(8,009)
Net flows[note (a)]	(3,325)	(1,261)	132	(4,454)
Shareholders' transfers post tax	(205)	–	–	(205)
Switches	(236)	236	–	–
Investment-related items and other movements[note (b)]	8,656	1,941	2,409	13,006
Foreign exchange translation differences	(98)	–	–	(98)
At 31 December 2012/1 January 2013	**94,933**	**22,197**	**27,308**	**144,438**
Comprising:				
Policyholder liabilities	**84,407**	**22,197**	**27,308**	**133,912**
Unallocated surplus of with-profits funds	**10,526**	**–**	**–**	**10,526**
Premiums	**3,750**	**2,150**	**1,478**	**7,378**
Surrenders	**(2,262)**	**(2,263)**	**(57)**	**(4,582)**
Maturities/Deaths	**(5,775)**	**(644)**	**(1,702)**	**(8,121)**
Net flows[note (a)]	**(4,287)**	**(757)**	**(281)**	**(5,325)**
Shareholders' transfers post tax	**(192)**	**–**	**–**	**(192)**
Switches	**(195)**	**195**	**–**	**–**
Investment-related items and other movements[note (b)]	**5,695**	**2,017**	**100**	**7,812**
Foreign exchange translation differences	**(117)**	**–**	**–**	**(117)**
At 31 December 2013	**95,837**	**23,652**	**27,127**	**146,616**
Comprising:				
Policyholder liabilities	**83,853**	**23,652**	**27,127**	**134,632**
Unallocated surplus of with-profits funds	**11,984**	**–**	**–**	**11,984**
Average policyholder liability balances*				
2013	**84,130**	**22,924**	**27,218**	**134,272**
2012	82,691	21,739	26,038	130,468

* Averages have been based on opening and closing balances and exclude unallocated surplus of with-profits funds.

Notes

(a) Net outflows increased from £4,454 million in 2012 to £5,325 million in 2013, driven primarily by lower sales of with-profits bonds in the year as a result from the implementation of the recommendations of the Retail Distribution Review and lower bulk annuity sales in 2013 compared to 2012. This increase is partly offset by a decrease in the outflow of the unit-linked business. The levels of inflows/outflows for unit-linked business is driven by corporate pension schemes with transfers in or out from only one or two schemes influencing the level of flows in the year. Excluding these transactions, the net flow in the unit-linked business for 2013 is broadly consistent to 2012.

(b) Investment-related items and other movements of £7,812 million reflects the strong growth in the UK equity markets in 2013, partly offset by the impact on liabilities of rising long-term bond yields.

ii Duration of liabilities

With the exception of most unitised with-profits bonds and other whole of life contracts the majority of the contracts of the UK insurance operations have a contract term. In effect, the maturity term of the other contracts reflects the earlier of death, maturity, or lapsation. In addition, as described in note A3.1, with-profits contract liabilities include projected future bonuses based on current investment values. The actual amounts payable will vary with future investment performance of SAIF and the WPSF.

The tables above show the carrying value of the policyholder liabilities. The tables' notes below show the maturity profile of the cash flows for insurance contracts, as defined by IFRS, ie those containing significant insurance risk, and investment contracts, which do not.

	2013 £m									
	With-profits business			Annuity business (Insurance contracts)			Other			
	Insurance contracts	Investment contracts	Total	Non-profit annuities within WPSF (including PAL)	PRIL	Total	Insurance contracts	Investment contracts	Total	TOTAL
Policyholders' liabilities	36,248	35,375	71,623	12,230	19,973	32,203	13,223	17,583	30,806	134,632
	2013 %									
Expected maturity:										
0 to 5 years	42	40	41	33	28	30	39	40	39	38
5 to 10 years	24	25	25	25	23	24	25	22	23	24
10 to 15 years	14	17	16	18	18	18	16	16	16	16
15 to 20 years	9	11	10	11	13	12	9	10	10	11
20 to 25 years	5	5	5	6	8	8	5	6	6	6
over 25 years	6	2	3	7	10	8	6	6	6	5

	2012 £m									
	With-profits business			Annuity business (Insurance contracts)			Other			
	Insurance contracts	Investment contracts	Total	Non-profit annuities within WPSF (including PAL)	PRIL	Total	Insurance contracts	Investment contracts	Total	TOTAL
Policyholders' liabilities	37,698	33,486	71,184	13,223	20,114	33,337	13,231	16,160	29,391	133,912
	2012 %									
Expected maturity:										
0 to 5 years	45	39	42	30	26	27	35	28	31	36
5 to 10 years	24	25	24	24	22	22	25	23	24	24
10 to 15 years	13	17	15	18	17	18	17	17	17	16
15 to 20 years	8	11	10	12	13	13	10	12	11	11
20 to 25 years	5	6	5	8	9	9	6	9	8	7
over 25 years	5	2	4	8	13	11	7	11	9	6

Notes

(i) The cash flow projections of expected benefit payments used in the maturity profile table above are from value of in-force business and exclude the value of future new business, including future vesting of internal pension contracts.

(ii) Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.

(iii) Investment contracts under 'Other' comprise certain unit-linked and similar contracts accounted for under IAS 39 and IAS 18.

(iv) For business with no maturity term included within the contracts, for example with-profits investment bonds such as Prudence Bonds, an assumption is made as to likely duration based on prior experience.

(v) The maturity tables shown above have been prepared on a discounted basis.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

C4.2 Products and determining contract liabilities

a Asia

Features of products and guarantees

The life insurance products offered by the Group's Asia operations include a range of with-profits and non-participating term, whole life, endowment and unit-linked policies. The Asia operations also offer health, disability, critical illness and accident coverage to supplement its core life products.

The terms and conditions of the contracts written by the Asia operations and in particular the products' options and guarantees, vary from territory to territory depending upon local market circumstances.

In general terms, the Asia participating products provide savings and protection where the basic sum assured can be enhanced by a profit share (or bonus) from the underlying fund as determined at the discretion of the insurers. The Asia operations' non-participating term, whole life and endowment products offer savings and/or protection where the benefits are guaranteed, or determined by a set of defined market-related parameters. Unit-linked products combine savings with protection, the cash value of the policy depends on the value of the underlying unitised funds. Health and Protection (H&P) policies provide mortality or morbidity benefits and include health, disability, critical illness and accident coverage. H&P products are commonly offered as supplements to main life policies but can be sold separately.

Product guarantees in Asia can be broadly classified into four main categories, namely premium rate, cash value or interest rate guarantees, policy renewability, and convertibility options.

Subject to local market circumstances and regulatory requirements, the guarantee features described in note C4.2(c) in respect of UK business broadly apply to similar types of participating contracts written in the Hong Kong branch, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

Non-participating long-term products are the only ones where the Group is contractually obliged to provide guarantees on all benefits. Unit-linked products have the lowest level of guarantee.

The risks on death coverage through premium rate guarantees are low due to the diversified nature of the business as well as rigorous product pricing.

Cash value and interest rate guarantees are of three types:

- Maturity values
  Maturity values are guaranteed for non-participating products and on the guaranteed portion of participating products. Declared annual bonuses are also guaranteed once vested. Future bonus rates and cash dividends are not guaranteed on participating products.

- Surrender values
  Surrender values are guaranteed for non-participating products and on the guaranteed portion of participating products. The surrender value of declared reversionary bonuses are also guaranteed once vested. Market value adjustments and surrender penalties are used for certain products and where the law permits such adjustments in cash values.

- Interest rate guarantees
  It is common in Asia for regulations or market-driven demand and competition to provide some form of capital value protection and minimum crediting interest rate guarantees. This would be reflected within the guaranteed maturity and surrender values.

The guarantees are borne by shareholders for non-participating and investment-linked (non-investment guarantees only) products. Participating product guarantees are predominantly supported by the segregated life funds and their estates.

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 are written in the Korean life operations though this is not to a significant extent as Korea has a much higher proportion of linked and health business. The Korean business has non-linked liabilities and linked liabilities at 31 December 2013 of £547 million and £1,905 million respectively (2012: £505 million and £1,628 million respectively).

Determining contract liabilities

For the with-profits business, the total value of the with-profits funds is driven by the underlying asset valuation with movements reflected principally in the accounting value of policyholder liabilities and unallocated surplus. Similarly, for the unit-linked business, the attaching liabilities reflect the unit value obligation driven by the value of the investments of the unit fund.

For the shareholder-backed non-linked business, the future policyholder benefit provisions for Asia businesses in the Group's IFRS accounts, are determined in accordance with methods prescribed by local GAAP adjusted to comply, where necessary, with the modified statutory basis or where local GAAP is not well established and in which the business written is primarily non-participating and linked business, US GAAP principles are used as the most appropriate reporting basis.

For the countries which apply local GAAP adjusted to comply, where necessary, with modified statutory basis, the approach to determining the contract liabilities is driven by the local solvency basis. A gross premium valuation method is used in those countries where a Risk-Based Capital framework is adopted for local solvency. Under the gross premium valuation method, all cash flows are valued explicitly using best estimate assumptions.

A Risk-Based Capital framework applying the gross premium valuation method is adopted by Singapore, Malaysia, Thailand and from 2013, Indonesia. In applying this approach, an overlay constraint to the method is applied such that no negative reserves are derived at an individual policyholder level.

In Vietnam, the Company improved its estimation basis for liabilities in 2012 from one determined substantially by reference to US GAAP requirements. After making this change, the estimation basis for Vietnam was aligned substantially to that used by the countries applying the gross premium valuation method.

For India, Japan, Taiwan, and until 2012, Vietnam, US GAAP is applied for measuring insurance assets and liabilities. For these countries, the future policyholder benefit provisions for non-linked business are determined using the net level premium method, with an allowance for surrenders, maintenance and claims expenses. Rates of interest used in establishing the policyholder benefit provisions vary by operation depending on the circumstances attaching to each block of business.

The other Asia operations principally adopt a net premium valuation method to determine the future policyholder benefit provisions.

The effect of changes in assumptions used to measure insurance assets and liabilities for Asia insurance operations is as disclosed in note B4(a).

b US

Features of products and guarantees

Jackson provides long-term savings and retirement products to retail and institutional customers throughout the US. Jackson offers fixed annuities (fixed interest rate annuities, fixed index annuities and immediate annuities), variable annuities, life insurance and institutional products. Jackson discontinued offering life insurance products in August 2012.

i Fixed annuities

Fixed interest rate annuities

At 31 December 2013, fixed interest rate annuities accounted for 10 per cent (2012: 13 per cent) of policy and contract liabilities of Jackson. Fixed interest rate annuities are primarily deferred annuity products that are used for asset accumulation in retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

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

The policy provides that at Jackson's discretion it may reset the interest rate, subject to a guaranteed minimum. At 31 December 2013, Jackson had fixed interest rate annuities totalling £11.2 billion (US$18.5 billion) (2012: £11.7 billion (US$19.0 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 5.5 per cent and a 3.05 per cent average guaranteed rate (2012: 1.0 per cent to 5.5 per cent and a 3.09 per cent average guaranteed rate).

Approximately 50 per cent (2012: 50 per cent) of the fixed interest rate annuities Jackson wrote in 2013 provide for a market value adjustment ('MVA') that could be positive or negative, on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment. While the MVA feature minimises the surrender risk associated with certain fixed annuities, Jackson still bears a portion of the surrender risk on policies without this feature, and the investment risk on all fixed interest rate annuities. In certain cases, additional provisions are held to reflect the existence of guarantees offered in the past that are no longer supported by earnings on the existing asset portfolio.

Fixed index annuities

Fixed index annuities accounted for 7 per cent (2012: 8 per cent) of Jackson's policy and contract liabilities at 31 December 2013. Fixed index annuities vary in structure, but generally are deferred annuities that enable policyholders to obtain a portion of an equity-linked return (based on participation rates and caps) but provide a guaranteed minimum return. These guaranteed minimum rates are generally set at 1.0 per cent to 3.0 per cent. Jackson had fixed index annuities allocated to indexed funds totalling £6.1 billion (US$10.2 billion) (2012: £5.6 billion (US$9.2 billion)) in account value with minimum guaranteed rates on index accounts ranging from 1.0 per cent to 3.0 per cent and a 1.85 per cent average guaranteed rate (2012: 1.0 per cent to 3.0 per cent and a 1.82 per cent average guarantee rate). Jackson also offers fixed interest accounts on some fixed index annuity products. Fixed interest accounts of fixed index annuities totalled £1.5 billion (US$2.5 billion) (2012: £1.5 billion (US$2.3 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 2.56 per cent average guaranteed rate (2012: 1.0 per cent to 3.0 per cent and a 2.53 per cent average guaranteed rate).

Jackson hedges the equity return risk on fixed index products using futures and options linked to the relevant index as well as through offsetting equity exposure in the variable annuities product. The cost of these hedges is taken into account in setting the index participation rates or caps. Jackson bears the investment risk and a portion of surrender risk on these products.

Immediate annuities

At 31 December 2013, immediate annuities accounted for 1 per cent (2012: 1 per cent) of Jackson's policy and contract liabilities. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years and/or the life of the policyholder. If the term is for the life of the policyholder, then Jackson's primary risk are mortality and reinvestment risks. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

ii Variable annuities

At 31 December 2013, variable annuities accounted for 65 per cent (2012: 60 per cent) of Jackson's policy and contract liabilities. Variable annuities are deferred annuities that have the same tax advantages and payout options as interest-sensitive and fixed index annuities. They are also used for asset accumulation in retirement planning and to provide income in retirement.

The primary differences between variable annuities and interest-sensitive or fixed index annuities are investment risk and return. If a policyholder chooses a variable annuity, the rate of return depends upon the performance of the selected fund portfolio. Policyholders may allocate their investment to either the fixed account or a selection of variable accounts. Investment risk on the variable account is borne by the policyholder, while investment risk on the fixed is borne by Jackson through guaranteed minimum fixed rates of return. At 31 December 2013, 6 per cent (2012: 8 per cent) of variable annuity funds were in fixed accounts. Jackson had accounts in variable annuities totalling £4.2 billion (US$7.0 billion) (2012: £4.3 billion (US$7.0 billion)) in account value with minimum guaranteed rates ranging from 1.0 per cent to 3.0 per cent and a 1.85 per cent average guaranteed rate (2012: 1.0 per cent to 3.0 per cent and a 1.89 per cent average guaranteed rate).

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

Jackson issues variable annuity contracts where it contractually guarantees to the contractholder 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 contract anniversary. These guarantees include benefits that are payable in the event of death (guaranteed minimum death benefit (GMDB)), annuitisation (guaranteed minimum income benefit (GMIB)), or at specified dates during the accumulation period (guaranteed minimum withdrawal benefit (GMWB) and guaranteed minimum accumulation benefit (GMAB)). Jackson hedges these risks using equity options and futures contracts as described in note C7.3. The GMAB and GMIB are no longer offered, with the existing GMIB coverage being substantially reinsured.

Jackson launched Elite Access in March 2012. Elite Access is a variable annuity which has no guaranteed benefits and provides tax efficient access to alternative investments. Single premium sales in 2013 were £2,585 million (2012: £849 million).

iii Aggregate distribution of account values

The table below shows the distribution of account values for fixed annuities (fixed interest rate and fixed index) and the fixed account portion of variable annuities within the range of minimum guaranteed interest rates as described in notes i to ii above as at 31 December 2013 and 2012:

	Account value	
Minimum guaranteed interest rate	**2013** £m	**2012** £m
1.0%	3,012	2,534
> 1.0% to 2.0%	8,349	8,374
> 2.0% to 3.0%	8,867	9,174
> 3.0% to 4.0%	1,163	1,236
> 4.0% to 5.0%	1,460	1,518
> 5.0%	197	209
Total	23,048	23,045

iv Life insurance

Life insurance products accounted for 14 per cent (2012: 15 per cent) of Jackson's policy and contract liabilities at 31 December 2013. Jackson discontinued new sales of life insurance products effective 1 August 2012 but increased its life insurance products book when it acquired REALIC in September 2012. Life products include term life and interest-sensitive life (universal life and variable universal life). Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a type of life insurance policy that combines death benefit protection with the ability for the policyholder account to be invested in separate account funds. For certain fixed universal life plans, additional provisions are held to reflect the existence of guarantees offered in the past that are no longer supported by earnings on the existing asset portfolio.

At 31 December 2013, Jackson had interest sensitive life business in force with total account value of £5.7 billion (US$9.5 billion) (2012: £6.0 billion (US$9.7 billion)), with minimum guaranteed interest rates ranging from 2.5 per cent to 6.0 per cent with a 4.65 per cent average guaranteed rate (2012: 2.5 per cent to 6.0 per cent with a 4.67 per cent average guaranteed rate). The table below shows the distribution of the interest-sensitive life business' account values within this range of minimum guaranteed interest rates as at 31 December 2013 and 2012:

	Account value	
Minimum guaranteed interest rate	**2013** £m	**2012** £m
< 2.0%	–	–
> 2.0% to 3.0%	182	183
> 3.0% to 4.0%	2,182	2,141
> 4.0% to 5.0%	1,908	2,097
> 5.0%	1,456	1,550
Total	5,728	5,971

v Institutional products

Jackson's institutional products consist of guaranteed investment contracts ('GICs'), funding agreements (including agreements issued in conjunction with Jackson's participation in the US Federal Home Loan Bank programme) and medium-term note funding agreements. At 31 December 2013, institutional products accounted for 3 per cent of policy and contract liabilities (2012: 3 per cent). Under a traditional GIC, the policyholder makes a lump sum deposit. The interest rate paid is fixed and established when the contract is issued. If deposited funds are withdrawn earlier than the specified term of the contract, an adjustment is made that approximates a market value adjustment.

Under a funding agreement, the policyholder either makes a lump sum deposit or makes specified periodic deposits. Jackson agrees to pay a rate of interest, which may be fixed but is usually a floating short-term interest rate linked to an external index. The average term of the funding agreements is one to two years. In 2013 and 2012, there were no funding agreements terminable by the policyholder with less than 90 days' notice.

Determining contract liabilities

Under the modified statutory basis of reporting applied under IFRS 4 for insurance contracts, providing the requirements of the Companies Act, UK GAAP standards and the ABI SORP are met, it is permissible to reflect the previously applied UK GAAP basis. Accordingly, and consistent with the basis explained in note A3.1, in the case of Jackson the carrying values of insurance assets and liabilities are consolidated into the Group accounts based on US GAAP. An overview of the deferral and amortisation of acquisition costs for Jackson is provided in note C5.1(b).

Under US GAAP, investment contracts (as defined for US GAAP purposes) are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts. These amounts are for:

- Any amounts that have been assessed to compensate the insurer for services to be performed over future periods (ie deferred income);
- Any amounts previously assessed against policyholders that are refundable on termination of the contract; and
- Any probable future loss on the contract (ie premium deficiency).

Capitalised acquisition costs and deferred income for these contracts are amortised over the life of the book of contracts. The present value of the estimated gross profits is generally computed using the rate of interest that accrues to policyholder balances (sometimes referred to as the contract rate). Estimated gross profits include estimates of the following elements, each of which will be determined based on the best estimate of amounts of the following individual elements over the life of the book of contracts without provision for adverse deviation for:

- Amounts expected to be assessed for mortality less benefit claims in excess of related policyholder balances;
- Amounts expected to be assessed for contract administration less costs incurred for contract administration;
- Amounts expected to be earned from the investment of policyholder balances less interest credited to policyholder balances;
- Amounts expected to be assessed against policyholder balances upon termination of contracts (sometimes referred to as surrender charges); and
- Other expected assessments and credits.

Variable annuity contracts written by Jackson may, as described above, provide for Guaranteed Minimum Death Benefit, Guaranteed Minimum Income Benefit, Guaranteed Minimum Withdrawal Benefit and Guaranteed Minimum Death Benefit features. In general terms, liabilities for these benefits are accounted for under US GAAP by using estimates of future benefits and fees under best estimate persistency assumptions.

In accordance with US GAAP, the 'grandfathered' basis for IFRS, which specifies how certain guarantee features should be accounted for, the Guaranteed Minimum Death Benefit and the 'for life' portion of Guaranteed Minimum Withdrawal Benefit liabilities are determined each period end by estimating the expected value of benefits in excess of the projected account balance and recognising the excess ratably over the life of the contract based on total expected assessments. At 31 December 2013, these liabilities were valued using a series of deterministic investment performance scenarios, a mean investment return of 7.4 per cent (2012: 8.4 per cent) net of external fund management fees, and assumptions for lapse, mortality and expense that are the same as those used in amortising the capitalised acquisition costs.

The direct Guaranteed Minimum Income Benefit liability is determined by estimating the expected value of the annuitisation benefits in excess of the projected account balance at the date of annuitisation and recognising the excess ratably over the accumulation period based on total expected assessments.

Guaranteed Minimum Income Benefit benefits are essentially fully reinsured, subject to a modest deductible and annual claim limits. As this reinsurance benefit is net settled, it is considered to be a derivative under IAS 39, and is therefore recognised at fair value with the change in fair value included as a component of short-term fluctuations. The direct GMIB liability is not considered a derivative instrument under IAS 39 and, as such, an accounting differences arises from this one-sided mark to market.

The assumptions used for calculating the direct Guaranteed Minimum Income Benefit liability at 31 December 2013 and 2012 are consistent with those used for calculating the Guaranteed Minimum Death Benefit and 'for life' Guaranteed Minimum Withdrawal Benefit liabilities. Guaranteed Minimum Withdrawal Benefit 'not for life' features are considered to be embedded derivatives under IAS 39. Therefore, provisions for these benefits are recognised at fair value. The change in these guaranteed benefit reserves, along with claim payments and associated fees included in reserves are included along with the hedge results in short-term fluctuations, resulting in removal of the market impact from the operating profit based on longer-term investment returns.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

Jackson regularly evaluates estimates used and adjusts the additional Guaranteed Minimum Death Benefit, Guaranteed Minimum Income Benefit and Guaranteed Minimum Withdrawal Benefit 'for life' liability balances, with a related charge or credit to benefit expense if actual experience or other evidence suggests that earlier assumptions should be revised.

For Guaranteed Minimum Withdrawal Benefit and Guaranteed Minimum Income Benefit reinsurance embedded derivatives that are fair valued under IAS 39, Jackson bases its volatility assumptions on implied market volatility for periods ranging from 5 to 10 years where sufficient market liquidity is assumed to exist, followed by grading to long-term historical volatility levels beyond that point, and explicitly incorporates Jackson's own credit risk in determining discount rates.

Non-performance risk is incorporated into the calculation through the use of discount interest rates sourced from a AA corporate credit curve. Other risk margins, particularly for policyholder behaviour are also incorporated into the model through the use of explicitly conservative assumptions. On a periodic basis, Jackson validates the resulting fair values based on comparisons to other models and market movements.

With the exception of the Guaranteed Minimum Death Benefit, Guaranteed Minimum Income Benefit, Guaranteed Minimum Withdrawal Benefit and Guaranteed Minimum Accumulation Benefit features of variable annuity contracts, the financial guarantee features of Jackson's contracts are in most circumstances not explicitly valued, but the impact of any interest guarantees would be reflected as they are earned in the current account value (ie the US GAAP liability).

For traditional life insurance contracts, provisions for future policy benefits are determined under US GAAP using the net level premium method and assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviation.

Institutional products are accounted for as investment contracts under IFRS with the liability classified as being in respect of financial instruments rather than insurance contracts, as defined by IFRS 4. In practice there is no material difference between the IFRS and US GAAP basis of recognition and measurement for these contracts.

Certain institutional products representing obligations issued in currencies other than US dollars have been hedged for changes in exchange rates using cross-currency swaps. The fair value of derivatives embedded in funding agreements, as well as foreign currency transaction gains and losses, are included in the carrying value of the trust instruments supported by funding agreements recorded in other non-insurance liabilities.

The effect of non-recurrent changes of assumptions used to measure insurance assets and liabilities of Jackson is shown in note B4(b).

c UK

Features of products and guarantees

Prudential's long-term products in the UK consist of life insurance, pension products and pension annuities.

These products are written primarily in:

- One of three separate sub-funds of the PAC long-term fund, namely the with-profits sub-fund (WPSF), SAIF, and the non-profit sub-fund;
- Prudential Annuities Limited (PAL), which is owned by the PAC with-profits sub-fund;
- Prudential Retirement Income Limited (PRIL), a shareholder-owned subsidiary; or
- Other shareholder-backed subsidiaries writing mainly non-profit unit-linked business.

i With-profits products and PAC with-profits sub-fund

The WPSF mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The WPSF's profits are apportioned 90 per cent to its policyholders and 10 per cent to shareholders as surplus for distribution is determined via the annual actuarial valuation.

The WPSF held a provision of £36 million at 31 December 2013 (2012: £47 million) to honour guarantees on a small amount of guaranteed annuity products. SAIF's exposure to guaranteed annuities is described below.

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 main factors that influence the determination of bonus rates are the return on the investments of the with-profits fund, inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. The overall rate of return earned on investments and the expectation of future investment returns are the most important influences on bonus rates.

A high proportion of the assets backing the with-profits business are invested in equities and real estate. If the financial strength of the with-profits business is affected, then a higher proportion of fixed interest or similar assets might be held by the fund.

Further details on the determination of the two types of the bonuses, 'regular' and 'final' are provided below:

Regular bonus rates

For regular bonuses, the bonus rates are determined for each type of policy primarily by targeting the bonus level at a prudent proportion of the long-term expected future investment return on underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by the date of payment of the premium, or date of issue of the policy, or if the accumulated annual bonuses are particularly high or low, relative to a prudent proportion of the achieved investment return.

When target bonus levels change, the PAC board of directors (PAC Board) has regard to the overall strength of the long-term fund when determining the length of time over which it will seek to achieve the amended prudent target bonus level.

In normal investment conditions, PAC expects changes in regular bonus rates to be gradual over time. However, PAC retains the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

Final bonus rates

A final bonus which is normally declared yearly, may be added when a claim is paid or when units of a unitised product are realised.

The rates of final bonus usually vary by type of policy and by reference to the period, usually a year, in which the policy commences or each premium is paid. These rates are determined by reference to the asset shares for the sample policies but subject to the smoothing approach as explained below.

In general, the same final bonus scale applies to maturity, death and surrender claims except that:

- The total surrender value may be impacted by the application of a Market Value Reduction for accumulating with-profits policies and by the surrender bases for conventional with-profits business; and
- For the SAIF and Scottish Amicable, the final bonus rates applicable on surrender may be adjusted to reflect expected future bonus rates.

Application of significant judgement

The application of the above method for determining bonuses requires the PAC Board to apply significant judgement in many respects, including in particular the following:

- Determining what constitutes fair treatment of customers: Prudential is required by UK law and regulation to consider the fair treatment of its customers in setting bonus levels. The concept of determining what constitutes fair treatment, while established by statute, is not defined;
- Smoothing of investment returns: This is an important feature of with-profits products. Determining when particular circumstances, such as a significant rise or fall in market values, warrant variations in the standard bonus smoothing limits that apply in normal circumstances requires the PAC Board to exercise significant judgement; and
- Determining at what level to set bonuses to ensure that they are competitive: The overall return to policyholders is an important competitive measure for attracting new business.

Key assumptions

As noted above, the overall rate of return on investments and the expectation of future investment returns are the most important influences in bonus rates, subject to the smoothing described below. Prudential determines the assumptions to apply in respect of these factors, including the effects of reasonably likely changes in key assumptions, in the context of the overarching discretionary and smoothing framework that applies to its with-profits business as described above. As such, it is not possible to specifically quantify the effects of each of these assumptions, or of reasonably likely changes in these assumptions.

Prudential's approach, in applying significant judgement and discretion in relation to determining bonus rates, is consistent conceptually with the approach adopted by other firms that manage a with-profits business. It is also consistent with the requirements of UK law, which require all UK firms that carry out a with-profits business to define, and make publicly available, the Principles and Practices of Financial Management (PPFM) that are applied in the management of their with-profits funds.

Accordingly, Prudential's PPFM contains an explanation of how it determines regular and final bonus rates within the discretionary framework that applies to all with-profits policies, subject to the general legislative requirements applicable. The purpose of Prudential's PPFM is therefore to:

- Explain the nature and extent of the discretion available;
- Show how competing or conflicting interests or expectations of different groups and generations of policyholders, and policyholders and shareholders are managed so that all policyholders and shareholders are treated fairly; and
- Provide a knowledgeable observer (eg a financial adviser) with an understanding of the material risks and rewards from starting and continuing to invest in a with-profits policy with Prudential.

Furthermore, in accordance with industry-wide regulatory requirements, the PAC Board has appointed:

- An Actuarial Function Holder who provides the PAC Board with all actuarial advice;
- A With-Profits Actuary whose specific duty is to advise the PAC Board on the reasonableness and proportionality of the manner in which its discretion has been exercised in applying the PPFM and the manner in which any conflicting interests have been addressed; and
- A With-Profits Committee of independent individuals, which assesses the degree of compliance with the PPFM and the manner in which conflicting rights have been addressed.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

Smoothing of investment return

In determining bonus rates for the UK with-profits policies, smoothing is applied to the allocation of the overall earnings of the UK with-profits fund of which the investment return is a significant element. The smoothing approach differs between accumulating and conventional with-profits policies to reflect the different contract features. In normal circumstances, Prudential does not expect most payout values on policies of the same duration to change by more than 10 per cent up or down from one year to the next, although some larger changes may occur to balance payout values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values, and in such situations the PAC Board may decide to vary the standard bonus smoothing limits in order to protect the overall interests of policyholders.

The degree of smoothing is illustrated numerically by comparing in the following table the relatively 'smoothed' level of policyholder bonuses declared as part of the surplus for distribution, with the more volatile movement in investment return and other items of income and expenditure of the UK component of the PAC with-profits fund for each year presented.

	2013 £m	2012* £m
Net income of the fund:		
Investment return	5,757	8,390
Claims incurred	(6,681)	(6,857)
Movement in policyholder liabilities	(197)	(3,989)
Add back policyholder bonuses for the year (as shown below)	1,749	1,865
Claims incurred and movement in policyholder liabilities (including charge for provision for asset shares and excluding policyholder bonuses)	(5,129)	(8,981)
Earned premiums, net of reinsurance	3,801	4,558
Other income	52	39
Acquisition costs and other expenditure	(1,025)	(907)
Share of profits from investment joint ventures	88	27
Tax charge	(308)	(286)
Net income of the fund before movement in unallocated surplus	3,236	2,840
Movement in unallocated surplus	(1,294)	(769)
Surplus for distribution	1,942	2,071
Surplus for distribution allocated as follows:		
90% policyholders' bonus (as shown above)	1,749	1,865
10% shareholders' transfers	193	206
	1,942	2,071

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

ii Annuity business

Prudential's conventional annuities include level, fixed-increase and inflation-linked annuities, the link being to the Retail Price Index (RPI) in the majority of cases. They are mainly written within the subsidiaries PAL, PRIL, the PAC non-profit sub-fund and the PAC with-profits sub-fund, but there are some annuity liabilities in Prudential Pensions Limited and SAIF.

Prudential's fixed-increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The RPI annuities that Prudential offers provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK RPI.

Prudential's with-profits annuities, which are written in the WPSF, combine the income features of annuity products with the investment smoothing features of with-profits products and enable policyholders to obtain exposure to investment return on the WPSF's equity shares, property and other investment categories over time. Policyholders select a 'required smoothed return' bonus from the specific range Prudential offers for the particular product. The amount of the annuity payment each year depends upon the relationship between the required smoothed return bonus rate selected by the policyholder when the product is purchased and the smoothed return bonus rates Prudential subsequently declares each year during the term of the product. If the total bonus rates fall below the anticipated rate, then the annuity income falls.

iii SAIF

SAIF is a ring-fenced sub-fund of the PAC long-term fund formed following the acquisition of the mutually owned Scottish Amicable Life Assurance Society in 1997. No new business may be written in SAIF, although regular premiums are still being paid on policies in force at the time of the acquisition and incremental premiums are permitted on these policies.

The fund is solely for the benefit of policyholders of SAIF. Shareholders have no interest in the profits of this fund although they are entitled to asset management fees on this business.

The process for determining policyholder bonuses of SAIF with-profits policies, which constitute the vast majority of obligations of the funds, is similar to that for the with-profits policies of the WPSF. However, in addition, the surplus assets in SAIF are allocated to policies in an orderly and equitable distribution over time as enhancements to policyholder benefits ie in excess of those based on asset share.

Provision is made for the risks attaching to some SAIF unitised with-profits policies that have (Market Value Reduction) MVR-free dates and for those SAIF products which have a guaranteed minimum benefit on death or maturity of premiums accumulated at 4 per cent per annum.

The Group's main exposure to guaranteed annuities in the UK is through SAIF and a provision of £328 million was held in SAIF at 31 December 2013 (2012: £371 million) to honour the guarantees. As SAIF is a separate sub-fund solely for the benefit of policyholders of SAIF, this provision has no impact on the financial position of the Group's shareholders' equity.

iv Unit-linked (non-annuity) and other non-profit business

Prudential UK insurance operations also have an extensive book of unit-linked policies of varying types and provide a range of other non-profit business such as credit life and protection contracts. These contracts do not contain significant financial guarantees.

There are no guaranteed maturity values or guaranteed annuity options on unit-linked policies except for minor amounts for certain policies linked to cash units within SAIF.

Determining contract liabilities

i Overview

The calculation of the contract liabilities involves the setting of assumptions for future experience. This is done following detailed review of the relevant experience including in particular mortality, expenses, tax, economic assumptions and, where applicable, persistency.

For with-profits business written in the WPSF or SAIF, a market consistent valuation is performed (as described in section (ii) below). Additional assumptions required are for persistency and the management actions under which the fund is managed. Assumptions used for a market-consistent valuation typically do not contain margins, whereas those used for the valuation of other classes of business do.

Mortality assumptions are set based on the results of the most recent experience analysis looking at the experience over recent years of the relevant business. For non-profit business, a margin for adverse deviation is added. Different assumptions are applied for different product groups. For annuitant mortality, assumptions for current mortality rates are based on recent experience investigations and expected future improvements in mortality. The expected future improvements are based on recent experience and projections of the business and industry experience generally.

Maintenance and, for some classes of business, termination expense assumptions are expressed as per policy amounts. They are set based on the expenses incurred during the year, including an allowance for ongoing investment expenditure and allocated between entities and product groups in accordance with the operation's internal cost allocation model. For non-profit business a margin for adverse deviation is added to this amount. Expense inflation assumptions are set consistent with the economic basis and based on the difference between yields on nominal gilts and index-linked gilts.

The actual renewal expenses incurred on behalf of SAIF by other Group companies are recharged in full to SAIF.

The assumptions for asset management expenses are based on the charges specified in agreements with the Group's asset management operations, plus a margin for adverse deviation for non-profit business.

Tax assumptions are set equal to current rates of taxation.

For non-profit business excluding unit-linked business, the valuation interest rates used to discount the liabilities are based on the yields as at the valuation date on the assets backing the technical provisions. For fixed interest securities the gross redemption yield is used except for the PAL (including the business recaptured by PAC WPSF in 2011) and PRIL annuity business where the internal rate of return of the assets backing the liabilities is used. Properties are valued using the rental yield, and for equities it is the greater of the dividend yield and the average of the dividend yield and the earnings yield. An adjustment is made to the yield on non-risk-free fixed interest securities and property to reflect credit risk. To calculate the non-unit reserves for linked business, assumptions have been set for the gross unit growth rate and the rate of inflation of maintenance expenses, as well as for the valuation interest rate as described above.

ii WPSF and SAIF

The policyholder liabilities reported for the WPSF are primarily for two broad types of business. These are accumulating and conventional with-profits contracts. The policyholder liabilities of the WPSF are accounted for under FRS 27.

The provisions have been determined on a basis consistent with the detailed methodology included in regulations contained in the PRA's rules for the determination of reserves on the PRA's 'realistic' Peak 2 basis. In aggregate, the regime has the effect of placing a value on the liabilities of UK with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances. These contracts are a combination of insurance and investment contracts with discretionary participation features, as defined by IFRS 4.

The PRA's Peak 2 calculation under the realistic regime requirement is explained further in note A3.1(d) under the UK regulated with-profits section.

The contract liabilities for with-profits business also require assumptions for persistency. These are set based on the results of recent experience analysis.

The process of determining policyholder liabilities of SAIF is similar to that for the with-profits policies of the WPSF.

C: Balance sheet notes continued

C4: Policyholder liabilities and unallocated surplus of with-profits funds continued

iii Annuity business

Credit risk provisions

For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowances made for credit risk. Further details on credit risk allowance are provided in note B4(c).

Mortality

The mortality assumptions are set in light of recent population and internal experience. The assumptions used are percentages of standard actuarial mortality tables with an allowance for future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives an additional age adjustment is made. The percentages of the standard table used are selected according to the source of business.

Since 2009, new mortality projection models have been released annually by the Continuous Mortality Investigation (CMI). The CMI 2011 model was used to produce the 2012 results, with calibration to reflect an appropriate view of future mortality improvements. The CMI 2012 model was used to produce the 2013 results, again with calibration to reflect an appropriate view of future mortality improvements.

The tables and range of percentages used are set out in the following tables:

	Non-profit annuities within the WPSF (including PAL)		PRIL	
2013	**Males**	**Females**	**Males**	**Females**
In payment	93% – 99% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2012 mortality model, with a long-term improvement rate of 2.25%.	89% – 101% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2012 mortality model, with a long-term improvement rate of 1.50%.	91% – 96% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2012 mortality model, with a long-term improvement rate of 2.25%.	84% – 98% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2012 mortality model, with a long-term improvement rate of 1.50%.
In deferment	AM92 minus 4 years	AF92 minus 4 years	AM92 minus 4 years	AF92 minus 4 years

	Non-profit annuities within the WPSF (including PAL)		PRIL	
2012	**Males**	**Females**	**Males**	**Females**
In payment	93% – 99% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2011 mortality model, with a long-term improvement rate of 2.25%.	89% – 101% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2011 mortality model, with a long-term improvement rate of 1.50%.	92% – 96% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2011 mortality model, with a long-term improvement rate of 2.25%.	84% – 97% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2011 mortality model, with a long-term improvement rate of 1.50%.
In deferment	AM92 minus 4 years	AF92 minus 4 years	AM92 minus 4 years	AF92 minus 4 years

	Non-profit annuities within the WPSF (including PAL)		PRIL	
2011	**Males**	**Females**	**Males**	**Females**
In payment	92% – 98% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2009 mortality model, with a long term improvement rate of 2.25%.	88% – 100% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2009 mortality model, with a long term improvement rate of 1.25%.	93% – 94% PCMA00 with future improvements in line with Prudential's own calibration of the CMI 2009 mortality model, with a long term improvement rate of 2.25%.	84% – 96% PCFA00 with future improvements in line with Prudential's own calibration of the CMI 2009 mortality model, with a long term improvement rate of 1.25%.
In deferment	AM92 minus 4 years	AF92 minus 4 years	AM92 minus 4 years	AF92 minus 4 years

iv Unit-linked (non-annuity) and other non-profit business

The majority of other long-term business written in the UK insurance operations is unit-linked business or other business with similar features. For these contracts the attaching liability reflects the unit value obligation and provision for expenses and mortality risk. The latter component is determined by applying mortality assumptions on a basis that is appropriate for the policyholder profile.

For unit-linked business, the assets covering unit liabilities are exposed to market risk, but the residual risk when considering the unit-linked liabilities and assets together is limited to the effect on fund-based charges.

For those contracts where the level of insurance risk is insignificant, the assets and liabilities arising under the contracts are distinguished between those that relate to the financial instrument liability and acquisition costs and deferred income that relate to the component of the contract that relates to investment management. Acquisition costs and deferred income are recognised consistent with the level of service provision in line with the requirements of IAS 18.

v Effect of changes in assumptions used to measure insurance assets and liabilities

Credit risk

There has been no change of approach in the setting of assumption levels of credit risk in 2013 and 2012. However, changes in the portfolio have given rise to altered levels of credit risk allowance as set out in note B4(c).

Other operating assumption changes

The effect of other operating assumption changes for the shareholder-backed business is set out in note B4 (c).

For the with-profits sub-fund, the aggregate effect of assumption changes in 2013 was a net credit to unallocated surplus of £200 million (2012: net charge of £90 million), relating to changes in mortality assumptions, offsetting releases of margins, and altered expense, persistency and economic assumptions, where appropriate in the two periods.

C: Balance sheet notes continued

C5: Intangible assets

C5.1 Intangible assets attributable to shareholders

a Goodwill attributable to shareholders

	2013 £m	2012 £m
Cost		
At beginning of year	1,589	1,585
Additional consideration paid on previously acquired business	–	2
Exchange differences	(8)	2
At end of year	1,581	1,589
Aggregate impairment	(120)	(120)
Net book amount at end of year	1,461	1,469
Goodwill attributable to shareholders comprises:		
M&G	1,153	1,153
Other	308	316
	1,461	1,469

Other goodwill represents amounts allocated to entities in Asia and the US operations in respect of acquisitions made prior to 2012. As discussed in note D1 there was no goodwill attached to the purchase of REALIC or Thanachart Life. Other goodwill amounts by acquired operations are not individually material.

The aggregate goodwill impairment of £120 million at 31 December 2013 and 2012 relates to the goodwill held in relation to the Japan life business which was impaired in 2005. The Group signed an agreement to sell the Japan life business in July 2013. The completion of the transaction is dependent on regulatory approval.

Impairment testing

Goodwill does not generate cash flows independently of other groups of assets and thus is assigned to cash-generating units for the purposes of impairment testing. These cash-generating units are based upon how management monitors the business and represent the lowest level to which goodwill can be allocated on a reasonable basis.

Assessment of whether goodwill may be impaired

Goodwill is tested for impairment by comparing the cash-generating units carrying amount, including any goodwill, with its recoverable amount.

With the exception of M&G, the goodwill attributable to shareholders mainly relates to acquired life businesses. The Company routinely compares the aggregate of net asset value and acquired goodwill on an IFRS basis of acquired life business with the value of the business as determined using the EEV methodology, as described in note 15. Any excess of IFRS over EEV carrying value is then compared with EEV basis value of current and projected future new business to determine whether there is any indication that the goodwill in the IFRS statement of financial position may be impaired. The assumptions underpinning the Group's EEV basis of reporting are included in the EEV basis supplementary information in this Annual Report.

M&G

The recoverable amount for the M&G cash-generating units has been determined by calculating its value in use. This has been calculated by aggregating the present value of future cash flows expected to be derived from the M&G operating segment (based upon management projections).

The discounted cash flow valuation has been based on a three-year plan prepared by M&G, and approved by management, and cash flow projections for later years.

The value in use is particularly sensitive to a number of key assumptions as follows:

i The set of economic, market and business assumptions used to derive the three-year plan. The direct and secondary effects of recent developments, eg changes in global equity markets, are considered by management in arriving at the expectations for the financial projections for the plan.

ii The assumed growth rate on forecast cash flows beyond the terminal year of the plan. A growth rate of 2.5 per cent (2012: 2.5 per cent) has been used to extrapolate beyond the plan period representing management's best estimate view of the long-term growth rate of the business after considering the future and past growth rates and external sources of data.

iii The risk discount rate. Differing discount rates have been applied in accordance with the nature of the individual component businesses. For retail and institutional business, a risk discount rate of 12 per cent (2012: 12 per cent) has been applied to post-tax cash flows. The pre-tax risk discount rate was 18 per cent (2012: 15 per cent). Management have determined the risk discount rate by reference to an average implied discount rate for comparable UK listed asset managers calculated by reference to risk-free rates, equity risk premiums of 5 per cent and an average 'beta' factor for relative market risk of comparable UK listed asset managers. A similar approach has been applied for the other component businesses of M&G.

iv That asset management contracts continue on similar terms.

Management believes that any reasonable change in the key assumptions would not cause the recoverable amount of M&G to fall below its carrying amount.

b Deferred acquisition costs and other intangible assets attributable to shareholders

The deferred acquisition costs and other intangible assets attributable to shareholders comprise:

	2013 £m	2012* £m
Deferred acquisition costs related to insurance contracts as classified under IFRS 4	4,684	3,776
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4	96	100
	4,780	3,876
Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF)	67	64
Distribution rights and other intangibles	448	237
	515	301
Total of deferred acquisition costs and other intangible assets	5,295	4,177

* The 2012 comparative results have been retrospectively adjusted from those previously published for the application of IFRS 11 described in note A2 whereby equity presentation rather than proportionate consolidation for joint venture operations applies.

	2013 £m						2012* £m
	Deferred acquisition costs						
	Asia	US	UK	Asset management	PVIF and other intangibles†	Total	Total
Balance at 1 January							
As previously reported	654	3,199	103	10	301	4,267	4,234
Effect of adoption of IFRS 11 note A2	(90)	–	–	–	–	(90)	(90)
After effect of change	564	3,199	103	10	301	4,177	4,144
Reclassification of Japan life as held for sale note D5	(28)	–	–	–	–	(28)	–
Additions	202	716	3	12	297	1,230	1,059
Acquisition of subsidiaries	–	–	–	–	21	21	5
Amortisation to the income statement:							
Operating profit	(167)	(403)	(17)	(5)	(51)	(643)	(682)
Non-operating profit	–	228	–	–	–	228	76
	(167)	(175)	(17)	(5)	(51)	(415)	(606)
Disposals	–	–	–	–	(1)	(1)	–
Exchange differences and other movements	(18)	(117)	–	–	(52)	(187)	(155)
Amortisation of DAC related to net unrealised valuation movements on Jackson's available-for-sale securities recognised within other comprehensive income	–	498	–	–	–	498	(270)
Balance at 31 December	553	4,121	89	17	515	5,295	4,177

* The 2012 comparative results have been retrospectively adjusted from those previously published for the application of IFRS 11 described in note A2 whereby equity presentation rather than proportionate consolidation for joint venture operations applies.

† PVIF and other intangibles includes software rights of £56 million (2012: £60 million) with additions of £26 million, amortisation of £27 million, disposals and other movements of £1 million and exchange losses of £2 million. The additions of £297 million for PVIF and other intangibles in 2013 include the amount advanced to secure the exclusive 15-year bancassurance partnership agreement entered into with Thanachart Bank in Thailand. Further, the addition of £21 million for acquisition of subsidiaries is for the acquisition of Thanachart Life. The amount of £5 million for 2012 was for the acquisition of REALIC. See note D1 for further details.

US insurance operations

Summary balances

The DAC amount in respect of US insurance operations comprises amounts in respect of:

	2013 £m	2012 £m
Variable annuity business	3,716	3,330
Other business	868	821
Cumulative shadow DAC (for unrealised gains/losses booked in other comprehensive income)*	(463)	(952)
Total DAC for US operations	4,121	3,199

* Consequent upon the negative unrealised valuation movement in 2013 of £2,089 million (2012: positive unrealised valuation movement of £862 million), there is a credit of £498 million (2012: a debit of £270 million) for altered 'shadow' DAC amortisation booked within other comprehensive income. These adjustments reflect movement from period to period, in the changes to the pattern of reported gross profits that would have happened if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 31 December 2013, the cumulative shadow DAC balance as shown in the table above was negative £463 million (2012: negative £952 million).

C: Balance sheet notes continued

C5: Intangible assets continued

Overview of the deferral and amortisation of acquisition costs for Jackson

Under IFRS 4, the Group applies 'grandfathered' US GAAP for measuring the insurance assets and liabilities of Jackson. In the case of Jackson term business, acquisition costs are deferred and amortised in line with expected profits. For annuity and interest-sensitive life business, acquisition costs are deferred and amortised in line with a combination of historical and future expected gross profits on the relevant contracts. For fixed and index annuity and interest-sensitive life business, the key assumption is the long-term spread between the earned rate on investments and the rate credited to policyholders, which is based on an annual spread analysis. Expected gross profits also depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all of which are based on a combination of actual experience of Jackson, industry experience and future expectations. A detailed analysis of actual mortality, lapse and expense experience is performed using internally developed experience studies.

As with fixed and index annuity and interest-sensitive life business, acquisition costs for Jackson's variable annuity products are amortised in line with the emergence of profits. The measurement of the amortisation in part reflects current period fees (including those for guaranteed minimum death, income, or withdrawal benefits) earned on assets covering liabilities to policyholders, and the historical and expected level of future gross profits which depends on the assumed level of future fees, as well as components related to mortality, lapse, and expense.

Mean reversion technique

For variable annuity products, under US GAAP (as 'grandfathered' under IFRS 4) the projected gross profits, against which acquisition costs are amortised, reflect an assumed long-term level of returns on separate account investments which, as referenced in note A2, for Jackson, is 7.4 per cent (2012: 8.4 per cent) after deduction of net external fund management fees. This is applied to the period end level of separate account assets after application of a mean reversion technique that removes a portion of the effect of levels of short-term variability in current market returns.

Under the mean reversion technique applied by Jackson, the projected level of return for each of the next five years is adjusted from period to period so that in combination with the actual rates of return for the preceding two years and the current period, the 7.4 per cent (2012: 8.4 per cent) annual return is realised on average over the entire eight-year period. Projected returns after the mean reversion period revert back to the 7.4 per cent (2012: 8.4 per cent) assumption.

However, to ensure that the methodology does not over anticipate a reversion to trend following adverse markets, the mean reversion technique has a cap and floor feature whereby the projected returns in each of the next five years can be no more than 15 per cent per annum and no less than 0 per cent per annum (both gross of asset management fees) in each year.

Sensitivity of amortisation charge

The amortisation charge to the income statement is reflected in both operating profit and short-term fluctuations in investment returns. The amortisation charge to the operating profit in a reporting period comprises:

i a core amount that reflects a relatively stable proportion of underlying premiums or profit; and

ii an element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

Furthermore, in those periods where the cap or floor is relevant, the mean reversion technique provides no further dampening and additional volatility may result.

In 2013, the DAC amortisation charge for operating profit was determined after including a credit for decelerated amortisation of £82 million (2012: £56 million). The 2013 amount primarily reflects the separate account performance of 20 per cent, which is higher than the assumed level for the year.

As noted above, the application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation while the mean reversion assumption lies within the corridor. It would take a significant movement in equity markets in 2014 (outside the range of negative 37 per cent to positive 27 per cent) for the mean reversion assumption to move outside the corridor.

Deferred acquisition costs related to insurance and investment contracts attributable to shareholders

Additional movement analysis of deferred acquisition costs and other intangibles attributable to shareholders

The movement in deferred acquisition costs relating to insurance and investment contracts attributable to shareholders are as follows:

	2013 £m		2012* £m	
	Insurance contracts	Investment management note	Insurance contracts	Investment management note
DAC at 1 January	3,776	100	3,716	105
Additions	920	14	1,013	12
Amortisation	(372)	(18)	(535)	(17)
Exchange differences	(138)	–	(148)	–
Change in shadow DAC related to movement in unrealised appreciation of Jackson's securities classified as available-for-sale	498	–	(270)	–
DAC at 31 December	4,684	96	3,776	100

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Note
All of the additions are through internal development. The carrying amount of the balance comprises the following gross and accumulated amortisation amounts:

	2013 £m	2012 £m
Gross amount	224	210
Accumulated amortisation	(128)	(110)
Net book amount	96	100

Present value of acquired in-force (PVIF) and other intangibles attributable to shareholders

	2013 £m				2012* £m			
		Other intangibles note (ii)				Other intangibles note (ii)		
	PVIF note (i)	Distri-bution rights	Software	Total	PVIF note (i)	Distri-bution rights	Software	Total
At 1 January								
Cost	217	230	184	631	212	235	153	600
Accumulated amortisation	(153)	(53)	(124)	(330)	(148)	(36)	(96)	(280)
	64	177	60	301	64	199	57	320
Additions (including amounts arising on acquisition of subsidiaries)	21	271	26	318	5	–	32	37
Amortisation charge	(7)	(17)	(27)	(51)	(5)	(17)	(28)	(50)
Disposals	(0)	–	(1)	(1)	–	–	–	–
Exchange differences and other movements	(11)	(39)	(2)	(52)	–	(5)	(1)	(6)
At 31 December	67	392	56	515	64	177	60	301
Comprising:								
Cost	221	458	203	882	217	230	184	631
Accumulated amortisation	(154)	(66)	(147)	(367)	(153)	(53)	(124)	(330)
	67	392	56	515	64	177	60	301

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) All of the PVIF balances relate to insurance contracts and are accounted for under UK GAAP as permitted by IFRS 4. The PVIF attaching to investment contracts have been fully amortised. Amortisation is charged to the 'acquisition costs and other operating expenditure' line in the income statement over the period of provision of asset management services as those profits emerge.

(ii) Other intangibles comprise distribution and software rights. Distribution rights relate to facilitation fees paid in respect of the bancassurance partnership arrangements in Asia for the bank distribution of Prudential's insurance products for a fixed period of time. The distribution rights amounts are amortised over the term of the distribution contracts. Software is amortised over its useful economic life, which generally represents the licence period of the software acquired. Amortisation is charged to the 'acquisition costs and other expenditure' line in the income statement.

C: Balance sheet notes continued

C5: Intangible assets continued

C5.2 Intangible assets attributable to with-profits funds

a Goodwill in respect of acquired investment subsidiaries for venture fund and other investment purposes

	2013 £m	2012 £m
At 1 January	178	178
Exchange differences	(1)	–
At 31 December	177	178

All the goodwill relates to the UK insurance operations segment.

The venture fund investments consolidated by the Group relates to investments of the PAC with-profits fund which are managed by M&G for which the goodwill is shown in the table above. Goodwill is tested for impairment of these investments by comparing the investment's carrying value including goodwill with its recoverable amount (fair value less costs to sell). The fair value is determined by using a discounted cash flow valuation based on cash flow projections to 2016 prepared by management after considering the historical experience and future growth rates of the business. The key assumption applied in the calculations is the risk discount rate which were from 10 to 14 per cent. The discount rates were derived by reference to risk-free rates and an equity premium risk. In 2013 and 2012, none of the goodwill was impaired.

b Deferred acquisition costs and other intangible assets

Other intangible assets in the Group consolidated statement of financial position attributable to with-profits funds consist of:

	2013 £m	2012 £m
Deferred acquisition costs related to insurance contracts attributable to the PAC with-profits fund[note]	6	6
Distribution rights attributable to with-profits funds of the Asia insurance operations	60	70
Computer software attributable to with-profits funds of the Asia insurance operations	6	2
	72	78

Note
The above costs relate to non-participating business written by the PAC with-profits sub-fund. As the with-profit contracts are accounted for under the UK regulatory 'realistic basis', no deferred acquisition costs are established for this type of business.

Distribution rights attributable to with-profits funds of the Asia insurance operations

Distribution rights relate to facilitation fees paid in relation to the bancassurance partnership arrangements in Asia for the bank distribution of Prudential's insurance products for a fixed period of time. The distribution rights amounts are amortised over the term of the distribution contracts.

	2013 £m	2012 £m
At 1 January		
Gross amount	92	96
Accumulated amortisation	(22)	(13)
	70	83
Amortisation charge	(9)	(9)
Exchange differences	(1)	(4)
At 31 December	60	70
Comprising:		
Gross amount	91	92
Accumulated amortisation	(31)	(22)
	60	70

C6: Borrowings

C6.1 Core structural borrowings of shareholder-financed operations

	2013 £m	2012 £m
Holding company operations:		
US$1,000m 6.5% Perpetual Subordinated Capital Securities	604	615
US$250m 6.75% Perpetual Subordinated Capital Securities note (vi)	151	154
US$300m 6.5% Perpetual Subordinated Capital Securities note (vi)	181	185
US$750m 11.75% Perpetual Subordinated Capital Securities	451	458
US$700m 5.25% Perpetual Subordinate Capital Securities note (iv),(vi)	417	–
US$550m 7.75% Perpetual Subordinated Capital Securities note (vi)	329	334
Perpetual subordinated capital securities (Innovative Tier 1) note (i),(iv)	2,133	1,746
€20m Medium Term Subordinated Notes 2023 note (vii)	17	16
£435m 6.125% Subordinated Notes 2031	429	429
£400m 11.375% Subordinated Notes 2039	388	386
£700m 5.7% Subordinated Notes 2063 note (v)	695	–
Subordinated notes (Lower Tier 2) note (i),(v)	1,529	831
Subordinated debt total	3,662	2,577
Senior debt: note (ii)		
£300m 6.875% Bonds 2023	300	300
£250m 5.875% Bonds 2029	249	249
Holding company total	4,211	3,126
Prudential Capital bank loan note (iii)	275	275
Jackson US$250m 8.15% Surplus Notes 2027 (Lower Tier 2) note (i),(viii)	150	153
Total (per consolidated statement of financial position)	4,636	3,554

Notes

(i) These debt classifications are consistent with the treatment of capital for regulatory purposes, as defined in the Prudential Regulation Authority handbook.
Tier 1 subordinated debt is entirely US$ denominated. The Group has designated all US$3.55 billion (2012: US$2.85 billion) of its Tier 1 subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.

(ii) The senior debt ranks above subordinated debt in the event of liquidation.

(iii) The Prudential Capital bank loan of £275 million has been made in two tranches: a £160 million loan maturing on 20 December 2017, currently drawn at a cost of 12 month £LIBOR plus 0.4 per cent and a £115 million loan also maturing on 20 December 2017 and currently drawn at a cost of 12 month £LIBOR plus 0.59 per cent.

(iv) In January 2013, the Company issued core structural borrowings of US$700 million 5.25 per cent Tier 1 Perpetual Subordinated Capital Securities primarily to retail investors in Asia. The proceeds, net of costs, were US$689 million.

(v) In December 2013, the Company issued core structural borrowings of £700 million Lower Tier 2 Subordinated notes primarily to UK institutional investors. The proceeds, net of costs, were £695 million.

(vi) These borrowings can be converted, in whole or in part, at the Company's option and subject to certain conditions, on any interest payment date, into one or more series of Prudential preference shares.

(vii) The €20 million borrowings were issued at 20-year Euro Constant Maturity Swap (capped at 6.5 per cent). These have been swapped into borrowings of £14 million with interest payable at three month £LIBOR plus 1.2 per cent.

(viii) The Jackson's borrowings are unsecured and subordinated to all present and future indebtedness, policy claims and other creditor claims of Jackson.

C: Balance sheet notes continued

C6: Borrowings continued

C6.2 Other borrowings

a Operational borrowings attributable to shareholder-financed operations

	2013 £m	**2012** £m
Commercial paper	1,634	1,535
Medium Term Notes 2013 note (ii)	–	250
Medium Term Notes 2015	299	299
Borrowings in respect of short-term fixed income securities programmes	1,933	2,084
Non-recourse borrowings of US operations	18	20
Bank loans and overdrafts	3	1
Obligations under finance leases	–	1
Other borrowings note (iii)	198	139
Other borrowings	201	141
Total note (i)	2,152	2,245

Notes

(i) In addition to the debt listed above, £200 million Floating Rate Notes were issued by Prudential plc in October 2013 which will mature in April 2014. These Notes have been wholly subscribed by a Group subsidiary and accordingly have been eliminated on consolidation in the Group financial statements. These notes were originally issued in October 2008 and have been reissued upon their maturity.

(ii) In January 2013 the Company repaid on maturity, £250 million Medium Term Notes included within borrowings in respect of short-term fixed income securities in the table above.

(iii) Other borrowings mainly include amounts whose repayment to the lender is contingent upon future surplus 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.

In addition, other borrowings include senior debt issued through the Federal Home Loan Bank of Indianapolis (FHLB), secured by collateral posted with the FHLB by Jackson.

In all instances the holders of the debt instruments issued by these subsidiaries and funds do not have recourse beyond the assets of those subsidiaries and funds.

b Borrowings attributable to with-profits operations

	2013 £m	**2012*** £m
Non-recourse borrowings of consolidated investment funds	691	759
£100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc†	100	100
Other borrowings (predominantly obligations under finance leases)	104	109
Total	895	968

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

† The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinate to the entitlements of the policyholders of that fund.

C6.3 Maturity analysis

The following table sets out the contractual maturity analysis of the Group's borrowings on the statement of financial position:

	Shareholder-financed operations				With-profits operations	
	Core structural borrowings		Operational borrowings		Borrowings	
	2013 £m	**2012** £m	**2013** £m	**2012** £m	**2013** £m	**2012*** £m
Less than 1 year	–	115	1,835	1,920	35	288
1 to 2 years	–	160	309	6	126	35
2 to 3 years	–	–	8	309	49	124
3 to 4 years	275	–	–	9	53	28
4 to 5 years	–	–	–	1	59	61
Over 5 years	4,361	3,279	–	–	573	432
Total	4,636	3,554	2,152	2,245	895	968

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

C7: Risk and sensitivity analysis

C7.1 Group overview

The Group's risk framework and the management of the risk including those attached to the Group's financial statements including financial assets, financial liabilities and insurance liabilities, together with the inter-relationship with the management of capital have been included in the audited sections of 'Group chief risk officer's report on the risks facing our business and our capital strength' within the Strategic Report.

As part of the risk management framework, the Group regularly monitors concentration of risk using a variety of risk monitoring tools, including scenario testing and sensitivity analysis of the Group's capital and profitability metrics involving IGD, Group economic capital, EEV and IFRS, to help identify concentrations of risks by risk types, products and business units, as well as the benefits of diversification of risks (as described further below). Business units are also required to disclose to the Group risk function all material risks, along with information on their severity and likelihood, and mitigating actions taken or planned. Credit risk remains one of the largest risk exposures. This reflects the relative size of exposure in Jackson and the UK shareholder annuities business. The Group manages concentration of credit risks by setting limits on the maximum exposure to each counterparty based on their credit ratings.

The financial and insurance assets and liabilities attaching to the Group's life assurance business are, to varying degrees, subject to market and insurance risk and other changes of experience assumptions that may have a material effect on IFRS basis profit or loss and shareholders' equity.

Market risk is the risk that the fair value or future cash flows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value will fluctuate because of changes in market prices. Market risk comprises three types of risk, namely:

- Foreign exchange risk: due to changes in foreign exchange rates;
- Interest rate risk: due to changes in market interest rates; and
- Other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or foreign exchange risk).

Policyholder liabilities relating to the Group's life assurance businesses are also sensitive to the effects of other changes in experience, or expected future experience, such as for mortality, other insurance risk and lapse risk.

Three key points are to be noted, namely:

- The Group's with-profits and unit-linked funds absorb most market risk attaching to the funds' investments. Except for second order effects, for example on asset management fees and shareholders' share of cost of bonuses for with-profits business, shareholder results are not directly affected by market value movements on the assets of these funds;
- The Group's shareholder results are most sensitive to market risks for assets of the shareholder-backed business; and
- The main exposures of the Group's IFRS basis results to market risk for its life assurance operations on investments of the shareholder-backed business are for debt securities.

The most significant items for which the IFRS shareholders' profit or loss and shareholders' equity for the Group's life assurance business is sensitive to these variables are shown in the following tables. The distinction between direct and indirect exposure is not intended to indicate the relative size of the sensitivity.

C: Balance sheet notes continued

C7: Risk and sensitivity analysis continued

Type of business	Market and credit risk			Insurance and lapse risk
	Investments/derivatives	Liabilities/unallocated surplus	Other exposure	
Asia insurance operations (see also section C7.2)				
All business	Currency risk			Mortality and morbidity risk Persistency risk
With-profits business	Net neutral direct exposure (indirect exposure only)		Investment performance subject to smoothing through declared bonuses	
Unit-linked business	Net neutral direct exposure (indirect exposure only)		Investment performance through asset management fees	
Non-participating business	Asset/liability mismatch risk			
	Credit risk	Interest rates for those operations where the basis of insurance liabilities is sensitive to current market movements		
	Interest rate and price risk			
US insurance operations (see also section C7.3)				
All business	Currency risk			Persistency risk
Variable annuity business	Net effect of market risk arising from incidence of guarantee features and variability of asset management fees offset by derivative hedging programme			
Fixed index annuity business	Derivative hedge programme to the extent not fully hedged against liability and fund performance	Incidence of equity participation features		
Fixed index annuities, Fixed annuities and GIC business	Credit risk Interest rate risk Profit and loss and shareholders' equity are volatile for these risks as they affect the values of derivatives and embedded derivatives and impairment losses. In addition, shareholders' equity is volatile for the incidence of these risks on unrealised appreciation of fixed income securities classified as available-for-sale under IAS 39		Spread difference between earned rate and rate credited to policyholders	Lapse risk, but the effects of extreme events are mitigated by the application of market value adjustments and by the use of swaption contracts

Type of business	Market and credit risk			Insurance and lapse risk
	Investments/derivatives	Liabilities/unallocated surplus	Other exposure	
UK insurance operations (see also section C7.4)				
With-profits business (including Prudential Annuities Limited)	Net neutral direct exposure (indirect exposure only)		Investment performance subject to smoothing through declared bonuses	Persistency risk to future shareholder transfers
SAIF sub-fund	Net neutral direct exposure (indirect exposure only)		Asset management fees earned by M&G	
Unit-linked business	Net neutral direct exposure (indirect exposure only)		Investment performance through asset management fees	Persistency risk
Shareholder-backed annuity business	Asset/liability mismatch risk Credit risk for assets covering liabilities and shareholder capital Interest rate risk for assets in excess of liabilities ie assets representing shareholder capital			Mortality experience and assumptions for longevity

Detailed analyses of sensitivity of IFRS basis profit or loss and shareholders' equity to key market and other risks by business unit are provided in notes C7.2, C7.3, C7.4 and C7.5. The sensitivity analyses provided show the effect on profit or loss and shareholders' equity to changes in the relevant risk variables, all of which are reasonably possible at the relevant balance sheet date.

Impact of diversification on risk exposure

The Group enjoys significant diversification benefits achieved through the geographical spread of the Group's operations and, within those operations through a broad mix of products types. This arises because not all risk scenarios are likely to happen at the same time and across all geographic regions. Relevant correlation factors include:

Correlation across geographic regions:
- Financial risk factors; and
- Non-financial risk factors.

Correlation across risk factors:
- Longevity risk;
- Expenses;
- Persistency; and
- Other risks.

The effect of Group diversification across the Group's life businesses is to significantly reduce the aggregate standalone volatility risk to IFRS operating profit based on longer-term investment returns. The effect is almost wholly explained by the correlations across risk types, in particular longevity risk.

C7.2 Asia insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks

The Asia operations sell with-profits and unit-linked policies and, although the with-profits business generally has a lower terminal bonus element than in the UK, the investment portfolio still contains a proportion of equities. Non-participating business is largely backed by debt securities or deposits. The Group's exposure to market risk arising from its Asia operations is therefore at modest levels. This reflects the fact that the Asia operations have a balanced portfolio of with-profits, unit-linked and other types of business.

In Asia, adverse persistency experience can impact the IFRS profitability of certain types of business written in the region. This risk is managed at a business unit level through regular monitoring of experience and the implementation of management actions as necessary. These actions could include product enhancements, increased management focus on premium collection as well as other customer retention efforts. The potential financial impact of lapses is often mitigated through the specific features of the products, eg surrender charges, or through the availability of premium holiday or partial withdrawal policy features.

In summary, for Asia operations, the operating profit based on longer-term investment returns is mainly affected by the impact of market levels on unit-linked persistency, and other insurance risks. At the total IFRS profit level the Asia result is affected by short-term value movements on the asset portfolio for non-linked shareholder-backed business.

C: Balance sheet notes continued

C7: Risk and sensitivity analysis continued

i Sensitivity to risks other than foreign exchange risk

With-profits business

Similar principles to those explained for UK with-profits business in C7.4 apply to profit emergence for the Asia with-profits business. Correspondingly, the profit emergence reflects bonus declaration and is relatively insensitive to period by period fluctuations in insurance risk or interest rate movements.

Unit-linked business

As for the UK insurance operations, for unit-linked business, the main factor affecting the profit and shareholders' equity of the Asia operations is investment performance through asset management fees. The sensitivity of profits and shareholders' equity to changes in insurance risk interest rate risk and credit risk are not material.

Other business

Interest rate risk

Excluding its with-profit and unit-linked business, the results of the Asia business are sensitive to the vagaries of routine movements in interest rates.

For the purposes of analysing sensitivity to variations in interest rates, reference has been made to the movements in the 10-year government bond rates of the territories. At 31 December 2013, 10-year government bond rates vary from territory to territory and range from 1.7 per cent to 9.0 per cent (2012: 0.6 per cent to 9.5 per cent).

For the sensitivity analysis as shown in the table below, the reasonably possible interest rate movement used is one per cent for all territories but subject to a floor of zero where the bond rates are currently below 1 per cent.

The estimated sensitivity to the decrease and increase in interest rates at 31 December 2013 and 2012 is as follows:

	2013 £m		**2012*** £m	
	Decrease of 1%	**Increase of 1%**	**Decrease of 1%**	**Increase of 1%**
Pre-tax profit	311	(215)	205	(259)
Related deferred tax (where applicable)	(34)	40	(45)	43
Net effect on profit and shareholders' equity	277	(175)	160	(216)

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

The pre-tax impacts, if they arose, would mostly be recorded within the category short-term fluctuations in investments returns in the Group's segmental analysis of profit before tax.

The degree of sensitivity of the results of the non-linked shareholder-backed business of the Asia operations to movements in interest rates depends upon the degree to which the liabilities under the 'grandfathered' IFRS 4 measurement basis reflects market interest rates from period to period. For example for those countries, such as those applying US GAAP, the results can be more sensitive as the effect of interest rate movements on the backing investments may not be offset by liability movements.

Equity price risk

The non-linked shareholder business has limited exposure to equity and property investment (£571 million at 31 December 2013). Generally changes in equity and property investment values are not directly offset by movements in policyholder liabilities.

The estimated sensitivity to a 10 per cent and 20 per cent change in equity and property prices for shareholder-backed Asia other business, which would be reflected in the short-term fluctuation component of the Group's segmental analysis of profit before tax, at 31 December 2013 and 2012 would be as follows:

	2013 £m		**2012*** £m	
	Decrease of 20%	**Decrease of 10%**	**Decrease of 20%**	**Decrease of 10%**
Pre-tax profit	(114)	(57)	(129)	(65)
Related deferred tax (where applicable)	24	12	26	13
Net effect on profit and shareholders' equity	(90)	(45)	(103)	(52)

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

A 10 or 20 per cent increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The market risk sensitivities shown above reflect the impact of temporary market movements and, therefore, the primary effect of such movements would, in the Group's segmental analysis of profits, be included within the short-term fluctuations in investment returns.

In the equity risk sensitivity analysis shown above, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put in place mitigating management actions.

Insurance risk

Many of the territories in Asia are exposed to mortality/morbidity risk and provision is made within policyholder liabilities on a prudent regulatory basis to cover the potential exposure. If these prudent assumptions were strengthened by 5 per cent then it is estimated that post tax profit would be decreased by approximately £38 million (2012: £30 million). Mortality and morbidity has a symmetrical effect on the portfolio and any weakening of these assumptions would have a similar equal and opposite impact.

ii Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Asia insurance operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2013, the rates for the most significant operations are given in note A1.

A 10 per cent increase or decrease in these rates would have reduced or increased profit before tax attributable to shareholders, profit for the year and shareholders' equity, excluding goodwill, attributable to Asia operations respectively as follows:

	A 10% increase in local currency to £ exchange rates		A 10% decrease in local currency to £ exchange rates	
	2013 £m	2012 £m	2013 £m	2012 £m
Profit before tax attributable to shareholders[note]	(63)	(90)	77	110
Profit for the year	(49)	(75)	60	92
Shareholders' equity, excluding goodwill, attributable to Asia operations	(246)	(243)	300	297

Note

Sensitivity on profit (loss) before tax ie aggregate of the operating profit based on longer-term investment returns and short-term fluctuations in investment returns.

C7.3 US insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks

At the level of operating profit based on longer-term investment returns, Jackson's results are sensitive to market conditions to the extent of income earned on spread-based products and second order equity-based exposure in respect of variable annuity asset management fees.

Jackson's main exposures are to market risk through its exposure to interest rate risk and equity risk. Approximately 94 per cent (2012: 94 per cent) of its general account investments support fixed interest rate and fixed index annuities, life business and surplus and 6 per cent (2012: 6 per cent) support institutional business. All of these types of business contain considerable interest rate guarantee features and, consequently, require that the assets that support them are primarily fixed income or fixed maturity.

Jackson is exposed primarily to the following risks:

Risks	Risk of loss
Equity risk	— Related to the incidence of benefits related to guarantees issued in connection with its VA contracts; and — Related to meeting contractual accumulation requirements in FIA contracts.
Interest rate risk	— Related to meeting guaranteed rates of accumulation on fixed annuity products following a sharp and sustained fall in interest rates; — Related to the guarantee features attaching to the company's products and to policyholder withdrawals following a sharp and sustained increase in interest rates; and — The risk of mismatch between the expected duration of certain annuity liabilities and repayment risk and extension risk inherent in mortgage-backed securities.

Jackson's derivative programme is used to manage interest rate risk associated with a broad range of products and equity market risk attaching to its equity-based products. Movements in equity markets, interest rates and credit spreads materially affect the carrying value of derivatives which are used to manage the liabilities to policyholders and backing investment assets. Combined with the use of US GAAP measurement (as 'grandfathered' under IFRS 4) for the insurance contracts assets and liabilities which is largely insensitive to current period market movements, the Jackson total profit (ie including short-term fluctuations in investment returns) is very sensitive to market movements. In addition to these effects the Jackson shareholders' equity is sensitive to the impact of interest rate and credit spread movements on the value of fixed income securities. Movements in unrealised appreciation on these securities are included as movement in shareholders' equity (ie outside the income statement).

C: Balance sheet notes continued

C7: Risk and sensitivity analysis continued

Jackson enters into financial derivative transactions, including those noted below to reduce and manage business risks. These transactions manage the risk of a change in the value, yield, price, cash flows or quantity of, or a degree of exposure with respect to assets, liabilities or future cash flows, which Jackson has acquired or incurred.

Jackson uses free-standing derivative instruments for hedging purposes. Additionally, certain liabilities, primarily trust instruments supported by funding agreements, fixed index annuities, certain GMWB variable annuity features and reinsured GMIB variable annuity features contain embedded derivatives as defined by IAS 39, 'Financial Instruments: Recognition and Measurement'. Jackson does not account for such derivatives as either fair value or cash flow hedges as might be permitted if the specific hedge documentation requirements of IAS 39 were followed. Financial derivatives, including derivatives embedded in certain host liabilities that have been separated for accounting and financial reporting purposes are carried at fair value.

Value movements on the derivatives are reported within the income statement. In preparing Jackson's segment profit as shown in note B1.1, value movements on Jackson's derivative contracts are included within short-term fluctuations in investment returns and excluded from operating results based on longer-term investment returns.

The principal types of derivatives used by Jackson and their purpose are as follows:

Derivative	Purpose
Interest rate swaps	These generally involve the exchange of fixed and floating payments over the period for which Jackson holds the instrument without an exchange of the underlying principal amount. These agreements are used for hedging purposes.
Put-swaption contracts	These contracts provide the purchaser with the right, but not the obligation, to require the writer to pay the present value of a long-duration interest rate swap at future exercise dates. Jackson purchases and writes put-swaptions with maturities up to 10 years. Put-swaptions hedge against significant movements in interest rates.
Equity index futures contracts and equity index options	These derivatives (including various call, put options and put spreads) are used to hedge Jackson's obligations associated with its issuance of fixed index immediate and deferred annuities and certain VA guarantees. Some of these annuities and guarantees contain embedded options which are fair valued for financial reporting purposes.
Total return swaps	Total return swaps in which Jackson receives equity returns or returns based on reference pools of assets in exchange for short-term floating rate payments based on notional amounts, are held for both hedging and investment purposes.
Cross-currency swaps	Cross-currency swaps, which embody spot and forward currency swaps and additionally, in some cases, interest rate swaps and equity index swaps, are entered into for the purpose of hedging Jackson's foreign currency denominated funding agreements supporting trust instrument obligations.
Credit default swaps	These swaps represent agreements under which Jackson has purchased default protection on certain underlying corporate bonds held in its portfolio. These contracts allow Jackson to sell the protected bonds at par value to the counterparty if a default event occurs in exchange for periodic payments made by Jackson for the life of the agreement. Jackson does not write default protection using credit derivatives.

The estimated sensitivity of Jackson's profit and shareholders' equity to equity and interest rate risks provided below is net of the related changes in amortisation of DAC. The effect on the related changes in amortisation of DAC provided is based on the current 'grandfathered' US GAAP DAC basis but does not include any effect from an acceleration or deceleration of amortisation of DAC.

i Sensitivity to equity risk

At 31 December 2013 and 2012, Jackson had variable annuity contracts with guarantees, for which the net amount at risk ('NAR') is defined as the amount of guaranteed benefit in excess of current account value, as follows:

31 December 2013	Minimum return	Account value £m	Net amount at risk £m	Weighted average attained age	Period until expected annuitisation
Return of net deposits plus a minimum return					
GMDB	0-6%	52,985	1,248	64.7 years	
GMWB – Premium only	0%	2,260	36		
GMWB*	0-5%	5,632	46		
GMAB – Premium only	0%	57	–		
Highest specified anniversary account value minus withdrawals post-anniversary					
GMDB		5,522	134	64.6 years	
GMWB – Highest anniversary only		2,039	93		
GMWB*		717	62		
Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary					
GMDB	0-6%	3,522	217	66.9 years	
GMIB‡	0-6%	1,642	317		2.4 years
GMWB*	0-8%	40,906	1,059		

31 December 2012	Minimum return	Account value £m	Net amount at risk £m	Weighted average attained age	Period until expected annuitisation
Return of net deposits plus a minimum return					
GMDB	0-6%	40,964	1,839	64.4 years	
GMWB – Premium only	0%	2,213	91		
GMWB*	0-5%†	3,359	88		
GMAB – Premium only	0%	53	–		
Highest specified anniversary account value minus withdrawals post-anniversary					
GMDB		4,554	324	64.0 years	
GMWB – Highest anniversary only		1,880	245		
GMWB*		697	137		
Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary					
GMDB	0-6%	2,705	348	66.4 years	
GMIB‡	0-6%	1,588	469		3.3 years
GMWB*	0-8%†	31,167	1,918		

* Amounts shown for Guaranteed Minimum Withdrawal Benefit comprise sums for the 'not for life' portion (where the guaranteed withdrawal base less the account value equals to the net amount at risk (NAR)), and a 'for life' portion (where the NAR has been estimated as the present value of future expected benefit payment remaining after the amount of the 'not for life' guaranteed benefits is zero).

† Ranges shown based on simple interest. The upper limits of 5 per cent, or 8 per cent simple interest are approximately equal to 4.1 per cent and 6 per cent respectively, on a compound interest basis over a typical ten year bonus period. For example 1 + 10 x 0.05 is similar to 1.041 growing at a compound rate of 4.01 per cent for a further nine years.

‡ The GMIB reinsurance guarantees are fully reinsured.

C: Balance sheet notes continued

C7: Risk and sensitivity analysis continued

Account balances of contracts with guarantees were invested in variable separate accounts as follows:

	2013 £m	2012 £m
Mutual fund type:		
Equity	40,529	28,706
Bond	10,043	10,433
Balanced	10,797	8,379
Money market	703	729
Total	62,072	48,247

As noted above, Jackson is exposed to equity risk through the options embedded in the fixed index liabilities and Guaranteed Minimum Death Benefit and Guaranteed Minimum Withdrawal Benefit guarantees included in certain variable annuity benefits as illustrated above. This risk is managed using an equity hedging programme to minimise the risk of a significant economic impact as a result of increases or decreases in equity market levels while taking advantage of naturally offsetting exposures in Jackson's operations. Jackson purchases external futures and options that hedge the risks inherent in these products, while also considering the impact of rising and falling separate account fees.

As a result of this hedging programme, if the equity markets were to increase further in the future, the net effect of Jackson's free-standing derivatives would decrease in value. However, over time, this movement would be broadly offset by increased separate account fees and reserve decreases, net of the related changes to amortisation of deferred acquisition costs. Due to the nature of the free-standing and embedded derivatives, this hedge, while highly effective on an economic basis, may not completely mute in the financial reporting of the immediate impact of equity market movements as the free-standing derivatives reset immediately while the hedged liabilities reset more slowly and fees are recognised prospectively. The opposite impact would be observed if the equity markets were to decrease.

In addition to the exposure explained above, Jackson is also exposed to equity risk from its holding of equity securities, partnerships in investment pools and other financial derivatives, including that relating to the reinsurance of Guaranteed Minimum Income Benefit guarantees.

At 31 December 2013, the estimated sensitivity of Jackson's profit, and shareholders' equity to immediate increases and decreases in equity markets is shown below. The sensitivities are shown net of related changes in DAC amortisation.

	2013 £m				2012 £m			
	Decrease of 20%	Decrease of 10%	Increase of 10%	Increase of 20%	Decrease of 20%	Decrease of 10%	Increase of 10%	Increase of 20%
Pre-tax profit, net of related changes in amortisation of DAC	485	165	77	213	295	139	(105)	(256)
Related deferred tax effects	(170)	(58)	(27)	(74)	(103)	(49)	37	89
Net sensitivity of profit after tax and shareholders' equity	315	107	50	139	192	90	(68)	(167)

Note
The table above has been prepared to exclude the impact of the instantaneous equity movements on the separate account fees. In addition, the sensitivity movements shown include those relating to the fixed index annuity and the reinsurance of GMIB guarantees.

The above table provides sensitivity movements as at a point in time while the actual impact on financial results would vary contingent upon the volume of new product sales and lapses, changes to the derivative portfolio, correlation of market returns and various other factors including volatility, interest rates and elapsed time.

The directional movements in the sensitivities reflect the hedging programme in place at 31 December 2013.

In the equity risk sensitivity analysis shown above, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put in place mitigating management actions.

ii Sensitivity to interest rate risk

Notwithstanding the market risk exposure previously described, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of fixed annuity liabilities of Jackson products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement. The GMWB features attaching to variable annuity business (other than 'for-life') are accounted for as embedded derivatives which are fair valued and so will be sensitive to changes in interest rate.

Debt securities and related derivatives are marked to fair value. Value movements on derivatives, again net of related changes to amortisation of DAC and deferred tax, are recorded within the income statement. Fair value movements on debt securities, net of related changes to amortisation of DAC and deferred tax, are recorded within other comprehensive income. The estimated sensitivity of these items and policyholder liabilities to a 1 per cent and 2 per cent decrease (subject to a floor of zero) and increase in interest rates at 31 December 2013 and 2012 is as follows:

	2013 £m				2012 £m			
	Decrease of 2%	Decrease of 1%	Increase of 1%	Increase of 2%	Decrease of 2%	Decrease of 1%	Increase of 1%	Increase of 2%
Profit and loss:								
Pre-tax profit effect (net of related changes in amortisation of DAC)	(128)	(66)	(52)	(161)	(187)	–	(54)	(186)
Related effect on charge for deferred tax	45	23	18	56	65	–	19	65
Net profit effect	(83)	(43)	(34)	(105)	(122)	–	(35)	(121)
Other comprehensive income:								
Direct effect on carrying value of debt securities (net of related changes in amortisation of DAC)	2,624	1,477	(1,477)	(2,624)	2,541	1,427	(1,427)	(2,541)
Related effect on movement in deferred tax	(918)	(517)	517	918	(889)	(499)	499	889
Net effect	1,706	960	(960)	(1,706)	1,652	928	(928)	(1,652)
Total net effect on shareholders' equity	1,623	917	(994)	(1,811)	1,530	928	(963)	(1,773)

These sensitivities are shown only for interest rates in isolation and do not include other movements in credit risk that may affect credit spreads and valuations of debt securities.

iii Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Group's US operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2013, the rates were US$1.56 (2012: US$1.58) and US$1.66 (2012: US$1.63) to £1.00 sterling, respectively. A 10 per cent increase or decrease in these rates would reduce or increase profit before tax attributable to shareholders, profit for the year and shareholders' equity attributable to US insurance operations respectively as follows:

	A 10% increase in US$:£ exchange rates		A 10% decrease in US$:£ exchange rates	
	2013 £m	2012 £m	2013 £m	2012 £m
Profit before tax attributable to shareholders[note]	(50)	(78)	61	95
Profit for the year	(41)	(56)	50	69
Shareholders' equity attributable to US insurance operations	(313)	(395)	383	483

Note
Sensitivity on profit before tax ie aggregate of the operating profit based on longer-term investment returns and short-term fluctuations in investment returns.

C: Balance sheet notes continued

C7: Risk and sensitivity analysis continued

iv Other sensitivities

Total profit of Jackson is very sensitive to market risk on the assets covering liabilities other than variable annuity business segregated in the separate accounts.

As with other shareholder-backed business the profit or loss for Jackson is presented by distinguishing the result for the year between an operating result based on longer-term investment returns and short-term fluctuations in investment returns. In this way the most significant direct effect of market changes that have taken place to the Jackson result are separately identified. The principal determinants of variations in operating profit based on longer-term returns are:

- Growth in the size of assets under management covering the liabilities for the contracts in force;
- Variations in fees and other income, offset by variations in market value adjustment payments and, where necessary, strengthening of liabilities;
- Spread returns for the difference between investment returns and rates credited to policyholders; and
- Amortisation of deferred acquisition costs.

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest sensitive life business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders, which is based on an annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges) all of which are based on a combination of actual experience of Jackson, industry experience and future expectations. A detailed analysis of actual experience is measured by internally developed expense, mortality and persistency studies.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and GMDB reserves, the profits of Jackson are relatively insensitive to changes in insurance risk.

Jackson is sensitive to lapse risk. However, Jackson uses derivatives to ameliorate the effect of a sharp rise in interest rates, which would be the most likely cause of a sudden change in policyholder behaviour.

For variable annuity business, the key assumption is the expected long-term level of separate account returns, which for 2013 was 7.4 per cent (2012: 8.4 per cent). The impact of using this return is reflected in two principal ways, namely:

- Through the projected expected gross profits which are used to determine the amortisation of deferred acquisition costs. This is applied through the use of a mean reversion technique which is described in more detail in note C5.1(b) above; and
- The required level of provision for guaranteed minimum death benefit claims.

C7.4 UK insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks

The IFRS basis results of the UK insurance operations are most sensitive to asset/liability matching, mortality and default rate experience and longevity assumptions and the difference between the return on corporate bond and risk-free rate for shareholder-backed annuity business of PRIL and the PAC non-profit sub-fund. Further details are described below.

The IFRS operating profit based on longer-term investment returns for UK insurance operations is sensitive to changes in longevity assumptions affecting the carrying value of liabilities to policyholders for UK shareholder-backed annuity business. At the total IFRS profit level, the result is particularly sensitive to temporary value movements on assets backing the capital of the shareholder-backed annuity business.

With-profits business

SAIF

Shareholders have no interest in the profits of the ring-fenced fund of SAIF but are entitled to the asset management fees paid on the assets of the fund.

With-profits sub-fund business

The shareholder results of the UK with-profits business (including non-participating annuity business of the WPSF and of Prudential Annuities Limited (PAL), which is owned by the WPSF) are only sensitive to market risk through the indirect effect of investment performance on declared policyholder bonuses.

The investment assets of PAC with-profits funds are subject to market risk. Changes in their carrying value, net of related changes to asset-share liabilities of with-profit contracts, affect the level of unallocated surplus of the fund. Therefore, the level of unallocated surplus is particularly sensitive to the level of investment returns on the portion of the assets that represents surplus. However, as unallocated surplus is accounted for as a liability under IFRS, movements in its value do not affect shareholders' profit and equity.

The shareholder results of the UK with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business which is currently one-ninth of the cost of bonuses declared. Investment performance is a key driver of bonuses, and hence the shareholders' share of the cost of bonuses. Due to the 'smoothed' basis of bonus declaration, the sensitivity to investment performance in a single year is low relative to movements in the period to period performance. However, over multiple periods, it is important.

Mortality and other insurance risk are relatively minor factors in the determination of the bonus rates. Adverse persistency experience can affect the level of profitability from with-profits but in any given one year, the shareholders' share of cost of bonus may only be marginally affected. However, altered persistency trends may affect future expected shareholder transfers.

Shareholder-backed annuity business

The principal items affecting the IFRS results of the UK shareholder-backed annuity business are mortality experience and assumptions, and credit risk. The assets covering the liabilities are principally debt securities and other investments that are held to match the expected duration and payment characteristics of the policyholder liabilities. These liabilities are valued for IFRS reporting purposes by applying discount rates that reflect the market rates of return attaching to the covering assets.

Except to the extent of any asset/liability duration mismatch which is reviewed regularly, and exposure to credit risk, the sensitivity of the Group's results to market risk for movements in the carrying value of the liabilities and covering assets is broadly neutral on a net basis.

The main market risk sensitivity for the UK shareholder-backed annuity business arises from interest rate risk on the debt securities which substantially represent shareholders' equity. This shareholders' equity comprises the net assets held within the long-term fund of the company that cover regulatory basis liabilities that are not recognised for IFRS reporting purposes, for example contingency reserves, and shareholder capital held outside the long-term fund.

In summary, profits from shareholder-backed annuity business are most sensitive to:

- The extent to which the duration of the assets held closely matches the expected duration of the liabilities under the contracts;
- Actual versus expected default rates on assets held;
- The difference between long-term rates of return on corporate bonds and risk-free rates;
- The variance between actual and expected mortality experience;
- The extent to which changes to the assumed rate of improvements in mortality give rise to changes in the measurement of liabilities; and
- Changes in renewal expense levels.

A decrease in assumed mortality rates of 1 per cent would decrease gross profits by approximately £71 million (2012: £74 million). A decrease in credit default assumptions of five basis points would increase gross profits by £151 million (2012: £157 million). A decrease in renewal expenses (excluding asset management expenses) of 5 per cent would increase gross profits by £27 million (2012: £25 million). The effect on profits would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above.

Unit-linked and other business

Unit-linked and other business represents a comparatively small proportion of the in-force business of the UK insurance operations.

Due to the matching of policyholder liabilities to attaching asset value movements the UK unit-linked business is not directly affected by market or credit risk. The liabilities of the other business are also broadly insensitive to market risk. Profits from unit-linked and similar contracts primarily arise from the excess of charges to policyholders for management of assets under the Company's stewardship, over expenses incurred. The former is most sensitive to the net accretion of funds under management as a function of new business and lapse and timing of death. The accounting impact of the latter is dependent upon the amortisation of acquisition costs in line with the emergence of margins (for insurance contracts) and amortisation in line with service provision (for the investment management component of investment contracts). By virtue of the design features of most of the contracts which provide low levels of mortality cover, the profits are relatively insensitive to changes in mortality experience.

i Sensitivity to interest rate risk and other market risk

By virtue of the fund structure, product features and basis of accounting, the policyholder liabilities of the UK insurance operations are, except annuity business, not generally exposed to interest rate risk. At 31 December 2013 annuity liabilities accounted for 98 per cent (2012: 98 per cent) of UK shareholder-backed business liabilities. For annuity business, liabilities are exposed to interest rate risk. However, the net exposure to the PAC WPSF (for PAL) and shareholders (for annuity liabilities of PRIL and the non-profit sub-fund) is very substantially ameliorated by virtue of the close matching of assets with appropriate duration. The level of matching from period to period can vary depending on management actions and economic factors so it is possible for a degree of mis-matching profits or losses to arise.

The close matching by the Group of assets of appropriate duration to annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and IFRS is not the same with contingency reserves and some other margins for prudence within the assumptions required under the regulatory solvency basis not included for IFRS reporting purposes. As a result IFRS equity is higher than regulatory capital and therefore more sensitive to interest rate and credit risk.

The estimated sensitivity of the UK non-linked shareholder-backed business (principally annuities business) to a movement in interest rates is as follows.

	2013 £m				2012 £m			
	A decrease of 2%	A decrease of 1%	An increase of 1%	An increase of 2%	A decrease of 2%	A decrease of 1%	An increase of 1%	An increase of 2%
Carrying value of debt securities and derivatives	8,602	3,843	(3,170)	(5,827)	9,006	3,993	(3,265)	(5,983)
Policyholder liabilities	(7,525)	(3,366)	2,762	5,054	(7,878)	(3,513)	2,867	5,235
Related deferred tax effects	(215)	(95)	82	155	(259)	(110)	91	172
Net sensitivity of profit after tax and shareholders' equity	862	382	(326)	(618)	869	370	(307)	(576)

C: Balance sheet notes continued

C7: Risk and sensitivity analysis continued

In addition the shareholder-backed portfolio of UK non-linked insurance operations covering liabilities and shareholders' equity includes equity securities and investment properties. Excluding any second order effects on the measurement of the liabilities for future cash flows to the policyholder, a fall in their value would have given rise to the following effects on pre-tax profit, profit after tax and shareholders' equity.

	2013 £m		**2012** £m	
	A decrease of 20%	**A decrease of 10%**	**A decrease of 20%**	**A decrease of 10%**
Pre-tax profit	(309)	(154)	(316)	(158)
Related deferred tax effects	72	36	73	36
Net sensitivity of profit after tax and shareholders' equity	(237)	(118)	(243)	(122)

A 10 or 20 per cent increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The market risk sensitivities shown above reflect the impact of temporary market movements, and, therefore the primary effect of such movements would, in the Group's segmental analysis of profits, be included within the short-term fluctuations in investment returns.

In the equity risk sensitivity analysis shown above, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put in place mitigating management actions.

C7.5 Asset management and other operations

a Asset management

i Sensitivities to foreign exchange risk

Consistent with the Group's accounting policies, the profits of Eastspring Investments and US asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. The rates for the functional currencies of most significant operations are shown in note A1.

A 10 per cent increase in the relevant exchange rates would have reduced reported profit before tax attributable to shareholders and shareholders' equity, excluding goodwill attributable to Eastspring Investments and US asset management operations, by £21 million (2012: £10 million) and £44 million (2012: £29 million) respectively.

ii Sensitivities to other financial risks for asset management operations

The principal sensitivities to other financial risk of asset management operations are credit risk on the bridging loan portfolio of the Prudential Capital operation and the indirect effect of changes to market values of funds under management. Due to the nature of the asset management operations there is limited direct sensitivity to movements in interest rates. Total debt securities held at 31 December 2013 by asset management operations were £2,045 million (2012: £1,839 million), the majority of which are held by the Prudential Capital operation. Debt securities held by M&G and Prudential Capital are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholders' equity. The Group's asset management operations do not hold significant investments in property or equities.

b Other operations

The Group holds certain derivatives that are used to manage foreign currency movements and macroeconomic exposures. The fair value of these derivatives is sensitive to the combined effect of movements in exchange rates, interest rates and inflation rates. The possible permutations cover a wide range of scenarios. For indicative purposes, a reasonably possible range of fair value movements could be plus or minus £75 million.

C8: Tax assets and liabilities

C8.1 Deferred tax

The statement of financial position contains the following deferred tax assets and liabilities in relation to:

	Deferred tax assets		Deferred tax liabilities	
	2013 £m	**2012*** £m	**2013** £m	**2012*** £m
Unrealised losses or gains on investments	315	100	(1,450)	(1,812)
Balances relating to investment and insurance contracts	8	1	(451)	(428)
Short-term timing differences	2,050	2,092	(1,861)	(1,715)
Capital allowances	10	15	(16)	(9)
Unused deferred tax losses	29	98	–	–
Total	2,412	2,306	(3,778)	(3,964)

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

The deferred tax asset at 31 December 2013 and 2012 arises in the following parts of the Group:

	2013 £m	**2012*** £m
UK insurance operations:		
SAIF	1	1
PAC with-profits fund (including PAL)	82	113
Other	59	69
US insurance operations	2,042	1,889
Asia insurance operations	55	76
Other operations	173	158
Total	2,412	2,306

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

The taxation regimes applicable across the Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the recognition of deferred tax assets. Accordingly, for the 2013 results and financial position at 31 December 2013 the possible tax benefit of approximately £127 million (2012: £158 million), which may arise from capital losses valued at approximately £0.6 billion (2012: £0.8 billion), is sufficiently uncertain that it has not been recognised. In addition, a potential deferred tax asset of £61 million (2012: £122 million), which may arise from trading tax losses and other potential temporary differences totalling £0.4 billion (2012: £0.5 billion) is sufficiently uncertain that it has not been recognised. Of these, losses of £54 million will expire within the next seven years. Of the remaining losses £0.5 million will expire within 20 years and the rest have no expiry date.

The table that follows provides a breakdown of the recognised deferred tax assets set out in the table above for both the short-term timing differences and unused tax losses split by business unit. The table also shows the period of estimated recoverability for each respective business unit. For these and each category of deferred tax asset recognised their recoverability against forecast taxable profits is not significantly impacted by any current proposed changes to future accounting standards.

	Short-term timing differences		Unused tax losses	
	2013 £m	**Expected period of recoverability**	**2013** £m	**Expected period of recoverability**
Asia	24	1 to 3 years	20	3 to 5 years
Jackson	1,733	With run-off of in-force book	–	–
UK long-term business	135	1 to 10 years	2	1 to 3 years
Other	158	1 to 10 years	7	1 to 3 years
Total	2,050		29	

Under IAS 12, 'Income Taxes', deferred tax is measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on the tax rates (and laws) that have been enacted or are substantively enacted at the end of the reporting periods.

C: Balance sheet notes continued

C8: Tax assets and liabilities continued

The reduction in the UK corporation tax rate to 21 per cent from 1 April 2014 and a further reduction to 20 per cent from 1 April 2015 was substantively enacted on 2 July 2013 which has had the effect of reducing the UK with-profits and shareholder-backed business element of the deferred tax balances as at 31 December 2013 by £51 million. As the 2013 Finance Act has been enacted at the balance sheet date, the effects of these changes are reflected in the financial statements for the year ended 31 December 2013.

C8.2 Current tax asset and liability

Of the £244 million (2012: £248 million) current tax recoverable, the majority is expected to be recovered in one year or less.

The current tax liability decreased to £395 million (2012: £443 million) reflecting the settlement of prior year balances in the UK and Asia following the agreement with taxation authorities.

C9: Defined benefit pension schemes

a Summary and background information

The Group asset/liability in respect of defined benefit pension schemes is as follows:

	2013 £m			2012 £m
	PSPS	Other schemes	Total	Total
Underlying economic surplus[note (c)]	726	(80)	646	1,138
Less: unrecognised surplus[note (c)]	(602)	–	(602)	(1,010)
Economic surplus (deficit) (including investment in Prudential insurance policies)[note (c)]	124	(80)	44	128
Attributable to:				
PAC with-profits fund	87	(58)	29	78
Shareholder-backed operations	37	(22)	15	50
Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies	–	(114)	(114)	(169)
IAS 19 pension asset (liability) on the Group statement of financial position*	124	(194)	(70)	(41)

* At 31 December 2013, the PSPS pension asset of £124 million (2012: £164 million) and the other schemes' pension liabilities of £194 million (2012: £205 million) are included within 'Other debtors' and 'Provisions' respectively on the consolidated statement of financial position.

The Group's businesses operate a number of pension schemes. The specific features of these plans vary in accordance with the regulations of the country in which the employees are located, although they are, in general, funded by the Group and based either on a cash balance formula or on years of service and salary earned in the last year or years of employment. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). PSPS accounts for 84 per cent (2012: 86 per cent) of the underlying scheme liabilities of the Group's defined benefit schemes.

The Group also operates two smaller UK defined benefit schemes in respect of Scottish Amicable and M&G. In addition, there are two small defined benefit schemes in Taiwan which have negligible deficits.

Triennial actuarial valuations

Defined benefit schemes in the UK are generally required to be subject to full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds.

The last completed actuarial valuation of PSPS was as at 5 April 2011, finalised in 2012 by CG Singer, Fellow of the Institute and Faculty of Actuaries, of Towers Watson Limited. This valuation demonstrated the scheme to be 111 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. Based on this valuation, future contributions into the scheme were reduced to the minimum level of contributions required under the scheme rules effective from July 2012. Excluding expenses, the contributions are now payable at approximately £6 million per annum for ongoing service of active members of the scheme. No deficit or other funding is required. Deficit funding for PSPS, where applicable, as applied prior to 2012, is apportioned in the ratio of 70/30 between the PAC with-profits fund and shareholder-backed operations following detailed consideration in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity.

The market value of PSPS scheme assets as at the 5 April 2011 valuation was £5,255 million. The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the purposes of the 2011 valuation were as follows.

Rate of increase in salaries	Nil
Rate of inflation:	
Retail Prices Index (RPI)	3.7
Consumer Prices Index (CPI)	3.0
Rate of increase of pensions in payment for inflation:	
Guaranteed (maximum 5%)	3.0
Guaranteed (maximum 2.5%)	2.5
Discretionary	Nil
Expected returns on plan assets	4.2

Mortality assumptions:
The tables used for PSPS pensions in payment at 5 April 2011 were:

Base post retirement mortality
For current male (female) pensioners 113% (108%) of the mortality rates of the 2000 series mortality tables (PNMA00/PNFA00), published by the Continuous Mortality Investigation Bureau (CMI).
For male (female) non-pensioners 107% (92%) of the 2000 series rates (PNMA00/PNFA00).

Allowance for future improvements to post retirement mortality
For males (females) 100% (75%) of Medium Cohort subject to a minimum rate of improvement of 2.00% (1.25%) up to the age of 90, decreasing linearly to zero by age of 120 with a long-term rate of 1.75% pa (1.5% pa) but adjusted as follows:

— Period improvements are blended between ages 60 to 80 to the long-term improvement rate over a 15 year period (compared with a 20 year period in the core CMI model); and
— Cohort improvements are assumed to dissipate over a 30 year period, or by age 90 if earlier (compared with a 40 year period, or by age 100 if earlier, in the core CMI model).

The last completed actuarial valuation of the Scottish Amicable Staff Pension Scheme (SASPS) was as at 31 March 2011, finalised in 2012 by Jonathan Seed, Fellow of the Institute and Faculty of Actuaries, of Xafinity Consulting. This valuation demonstrated the scheme to be 85 per cent funded. Based on this valuation, it was agreed with the Trustees that the existing level of deficit funding of £13.1 million per annum continues to be paid into the scheme until 31 December 2018, to eliminate the actuarial deficit. The deficit funding will be reviewed every three years at subsequent valuations.

The last completed actuarial valuation of the M&G Group Pension Scheme (M&GGPS) was as at 31 December 2011, finalised in 2012 by Paul Belok, Fellow of the Institute and Faculty of Actuaries, of Aon Hewitt Limited. This valuation demonstrated the scheme to be 83 per cent funded. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a three year period are being made from January 2013 of £18.6 million per annum for the first two years and £9.3 million in the third year.

Summary economic and IAS 19 financial positions
Under the IAS 19 'Employee Benefits' valuation basis, the Group applies IFRIC 14, 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. Under IFRIC 14, a surplus is only recognised to the extent that the Company is able to access the surplus either through an unconditional right of refund to the surplus or through reduced future contributions relating to ongoing service, which have been substantively enacted or contractually agreed. Further, the IFRS financial position recorded, reflects the higher of any underlying IAS 19 deficit and any obligation for committed deficit funding where applicable. For PSPS, the Group does not have an unconditional right of refund to any surplus of the scheme.

The underlying IAS 19 surplus for PSPS at 31 December 2013 was £726 million (31 December 2012: £1,174 million) of which reflecting the arrangements under the scheme rules, only a portion of the surplus, being £124 million (2012: £164 million) is recognised as recoverable. The £124 million (2012: £164 million) represents the present value of the economic benefit to the Company from the difference between future ongoing contributions to the scheme and estimated accrued cost of service. Of this amount, £87 million has been allocated to the PAC with-profits fund and £37 million was allocated to the shareholders' fund (2012: £115 million and £49 million, respectively).

The IAS 19 deficit of the SASPS at 31 December 2013 was a deficit of £115 million (2012: deficit of £74 million) and has been allocated approximately 50 per cent to the PAC with-profits fund and 50 per cent to the shareholders' fund.

The IAS 19 surplus of the M&GGPS on an economic basis at 31 December 2013 was a surplus of £36 million (2012: surplus of £38 million) and is wholly attributable to shareholders. The underlying position on an economic basis reflects the assets (including investments in Prudential insurance policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. As at 31 December 2013, the M&GGPS has invested £114 million in Prudential insurance policies (2012: £169 million). After excluding these investments that are offset against liabilities to policyholders, the IAS 19 basis position of the M&GGPS is a deficit of £78 million (2012: deficit of £131 million).

C: Balance sheet notes continued

C9: Defined benefit pension schemes continued

Risks to which the defined benefit schemes expose the Group

Responsibility of making good of any deficit that may arise in the schemes lies with the employers of the schemes, which are subsidiaries of the Group. Accordingly, the pension schemes expose the Group to a number of risks and the most significant of which are detailed below:

- Interest rate and investment risk – this risk arises because the schemes are not invested wholly in assets that most closely match the expected future cash flows. Therefore, falling equity markets and bond yields may lead to higher deficits in the schemes. Details of the investment portfolio of the schemes are provided in note 3;
- Inflation risk – the majority of the benefit obligations of all three schemes are linked to inflation, and higher inflation will lead to higher liabilities; and
- Mortality risk – increases in life expectancy of the members would mean that benefits are paid for longer and will result in an increase in the scheme's liabilities.

Corporate governance

The Group's UK pension schemes are regulated by 'The Pension Regulator' in accordance with the Pension Act 1995. Trustees have been appointed for each pension scheme and they have the ultimate responsibility to ensure that the scheme is managed in accordance with the Trust Deed & Rules. The Trustees are required by the Pension Regulator to be well conversant with the Trust Deed & Rules and to act in accordance with these Rules.

The Rules of the Group's largest pension arrangement, the defined benefit section of PSPS, a final salary scheme, specify that, in exercising its investment powers, the Trustee's objective is to achieve the best overall investment return consistent with the security of the assets of the scheme. In doing this, consideration is given to the nature and duration of the scheme's liabilities. The Trustee sets the benchmark for the asset mix, following analysis of the liabilities by the Scheme's Actuary and, having taken advice from the Investment Managers, then selects benchmark indices for each asset type in order to measure investment performance against a benchmark return.

The Trustee reviews strategy, the asset mix benchmark and the Investment Managers' objectives every three years, to coincide with the Actuarial Valuation, or earlier if the Scheme Actuary recommends. Interim reviews are conducted annually based on changing economic circumstances and financial market levels.

The Trustee sets the general investment policy and specifies any restrictions on types of investment and the degrees of divergence permitted from the benchmark, but delegates the responsibility for selection and realisation of specific investments to the Investment Managers. In carrying out this responsibility, the Investment Managers are required by the Pensions Act 1995 to have regard to the need for diversification and suitability of investments. Subject to a number of restrictions contained within the relevant asset management agreements, the Investment Managers are authorised to invest in any class of investment asset. However, the Investment Managers will not invest in any new class of investment asset without prior consultation with the Trustee.

The Trustee consults the Principal Employer, the Prudential Assurance Company, on the investment principles, but the ultimate responsibility for the investment of the assets of the scheme lies with the Trustee.

The investment policies and strategies for the other two UK defined benefit schemes (the SASPS and M&GGPS, which are both final salary schemes), follow similar principles, but have different target allocations reflecting the particular requirements of the schemes. All of the three UK schemes are closed to new entrants.

The majority of the scheme liabilities are linked to inflation. The assets that would most closely match the liabilities are a combination of index-linked government bonds or investment grade derivatives to match these inflation-linked liabilities and fixed interest gilts to match the fixed liabilities of the schemes. These 'matching assets' generally are expected to generate lower future returns than asset classes such as equities. The risk that must be traded off against investing in higher expected returns assets is increased volatility of the schemes' return and higher risk of default.

The Trustee of each of the schemes manages the investment strategy of the scheme to achieve an acceptable balance between investing in the assets that most closely match the expected benefit payments and assets that are expected to achieve a greater return in the hope of reducing the contributions required or providing additional benefits to members. When determining the investment strategy, the Trustee considers the risk that falls in asset values may not be matched by similar falls in the value of the schemes' liabilities. It also consults the Principal Employer, in order to understand the Principal Employer's appetite for bearing this risk and considers the Employer's ability to make good any shortfall that may arise.

The PSPS scheme has entered into a derivatives based strategy to match the duration and inflation profile of its liabilities. This involved a reallocation from other investments to other assets with an interest and inflation swap overlay. In broad terms, the scheme is committed to making a series of payments related to LIBOR on a nominal amount and in return, the scheme receives a series of fixed and inflation-linked payments which match a proportion of its liabilities. As at 31 December 2013, the nominal value of the interest and inflation-linked swaps amounted to £0.8 billion (2012: £0.9 billion) and £2.7 billion (2012: £2.0 billion) respectively.

The SASPS and M&GGPS use very limited or no derivatives to hedge their risks. The risks arising from these schemes are managed through well diversified investments with a portion of the scheme assets invested in inflation-indexed bonds to provide a partial hedge against inflation. The M&G pension scheme also invests in leveraged gilts as part of its asset liability management.

b Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the years ended 31 December were as follows:

	2013 %	2012 %
Discount rate*	4.4	4.4
Rate of increase in salaries	3.3	2.7
Rate of inflation†:		
Retail prices index (RPI)	3.3	2.7
Consumer prices index (CPI)	2.3	2.0
Rate of increase of pensions in payment for inflation:		
PSPS:		
Guaranteed (maximum 5%)	2.5	2.5
Guaranteed (maximum 2.5%)	2.5	2.5
Discretionary	2.5	2.5
Other schemes	3.3	2.7

* The discount rate has been determined by reference to an 'AA' corporate bond index, adjusted where applicable, to allow for the difference in duration between the index and the pension liabilities.
† The rate of inflation reflects the long-term assumption for the UK RPI or CPI depending on the tranche of the schemes.

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The specific allowance made is in line with a custom calibration and has been updated in 2013 to reflect the 2011 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries (CMI). The tables used for PSPS immediate annuities in payment at 31 December 2013 were:

Male: 112.0 per cent PNMA00 with improvements in line with a custom calibration of the CMI's 2011 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and

Female: 108.5 per cent PNFA00 with improvements in line with a custom calibration of the CMI's 2011 mortality model, with a long-term mortality improvement rate of 1.25 per cent per annum.

The tables used for PSPS immediate annuities in payment at 31 December 2012 were:

Male: 108.6 per cent PNMA00 with improvements in line with a custom calibration of the CMI's 2009 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and

Female: 103.4 per cent PNFA00 with improvements in line with a custom calibration of the CMI's 2009 mortality model, with a long-term mortality improvement rate of 1.00 per cent per annum.

The assumed life expectancies on retirement at age 60, based on the mortality table used was:

	2013 years		2012 years	
	Male	Female	Male	Female
Retiring today	27.9	29.5	28.0	29.1
Retiring in 20 years' time	31.5	32.8	30.6	31.2

The mean term of the current PSPS liabilities is around 17 years.

Using external actuarial advice provided by the scheme actuaries being Towers Watson for the valuation of PSPS, Xafinity Consulting for SASPS and Aon Hewitt Limited for the M&GGPS, the most recent full valuations have been updated to 31 December 2013, applying the principles prescribed by IAS 19.

c Estimated pension scheme surpluses and deficits

This section illustrates the financial position of the Group's defined benefit pension schemes on an economic basis and the IAS 19 basis.

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. The IAS 19 basis excludes the investments in Prudential policies. At 31 December 2013, the investments in Prudential insurance policies comprise £143 million (2012: £123 million) for PSPS and £114 million (2012: £169 million) for the M&GGPS. In principle, on consolidation, the investments are eliminated against policyholder liabilities of UK insurance operations so that the formal IAS 19 position for the schemes in isolation excludes these items. This treatment applies to the M&GGPS investments. However, as a substantial portion of the Company's interest in the underlying surplus of PSPS is not recognised, the adjustment is not necessary for the PSPS investments.

C: Balance sheet notes continued

C9: Defined benefit pension schemes continued

Movements on the pension scheme deficit determined on the economic basis are as follows, with the effect of the application of IFRIC 14 being shown separately:

	2013 £m				
		(Charge) credit to income statement or other comprehensive income			
	Surplus (deficit) in schemes at 1 January 2013	Operating results (based on longer-term investment returns)	Actuarial and other gains and losses	Contributions paid	Surplus (deficit) in schemes at 31 Dec 2013
All schemes					
Underlying position (without the effect of IFRIC 14)					
Surplus	1,138	15	(563)	56	646
Less: amount attributable to PAC with-profits fund	(787)	(21)	366	(15)	(457)
Shareholders' share:					
Gross of tax surplus (deficit)	351	(6)	(197)	41	189
Related tax	(81)	1	50	(8)	(38)
Net of shareholders' tax	270	(5)	(147)	33	151
Application of IFRIC 14 for the derecognition of PSPS surplus					
Derecognition of surplus	(1,010)	(39)	447	–	(602)
Less: amount attributable to PAC with-profits fund	709	32	(313)	–	428
Shareholders' share:					
Gross of tax surplus (deficit)	(301)	(7)	134	–	(174)
Related tax	69	2	(36)	–	35
Net of shareholders' tax	(232)	(5)	98	–	(139)
With the effect of IFRIC 14					
Surplus (deficit)	128	(24)	(116)	56	44
Less: amount attributable to PAC with-profits fund	(78)	11	53	(15)	(29)
Shareholders' share:					
Gross of tax surplus (deficit)	50	(13)	(63)	41	15
Related tax	(12)	3	14	(8)	(3)
Net of shareholders' tax	38	(10)	(49)	33	12

Underlying investments and liabilities of the schemes

On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the plans' net assets at 31 December comprise the following investments and liabilities:

	2013				2012†			
	PSPS £m	Other schemes £m	Total £m	%	PSPS £m	Other schemes £m	Total £m	%
Equities:								
UK	133	76	209	3	123	63	186	3
Overseas	12	317	329	5	–	249	249	3
Bonds*:								
Government	4,288	311	4,599	66	4,754	274	5,028	70
Corporate	715	107	822	12	454	141	595	8
Asset-backed securities	45	17	62	1	39	3	42	1
Derivatives	91	6	97	1	165	11	176	2
Properties	71	44	115	2	167	40	207	3
Other assets	687	24	711	10	698	16	714	10
Total value of assets	6,042	902	6,944	100	6,400	797	7,197	100

* 97 per cent of the bonds are investment graded (2012: 98 per cent).
† The 2012 comparatives have been reclassified to align to the current year's asset categorisation.

The movements in the IAS 19 pension schemes' surplus and deficit between scheme assets and liabilities as consolidated in the financial statements were:

Attributable to policyholders and shareholders

	2013 £m						
	Plan assets[(i)]	Present value of benefit obligations[(i),(ii)]	Net surplus (deficit) (without the effect of IFRIC 14)	Effect of IFRIC 14 for derecognition of PSPS surplus	Economic basis net surplus (deficit)	Other adjustments including for investments in Prudential insurance policies[(iii)]	IAS 19 basis net deficit[(i)]
Net deficit, beginning of year	7,197	(6,059)	1,138	(1,010)	128	(169)	(41)
Current service cost		(27)	(27)		(27)		(27)
Net interest on net defined benefit liability (asset)	313	(267)	46	(39)	7	(8)	(1)
Administration expenses paid out of plan assets	(4)		(4)		(4)		(4)
Benefit payments	(254)	254	–		–		–
Employers' contributions[note (iv)]	56		56		56		56
Employees' contributions	2	(2)	–		–		–
Actuarial and other gains and losses[note (v)]	(366)	(197)	(563)	447	(116)	1	(115)
Transfer out of investment in Prudential insurance policies			–		–	62	62
Net surplus (deficit), end of year	6,944	(6,298)	646	(602)	44	(114)	(70)

	2012 £m						
	Plan assets[(i)]	Present value of benefit obligations[(i),(ii)]	Net surplus (deficit) (without the effect of IFRIC 14)	Effect of IFRIC 14 for derecognition of PSPS surplus	Economic basis net surplus (deficit)	Other adjustments including for investments in Prudential insurance policies[(iii)]	IAS 19 basis net deficit[(i)]
Net deficit, beginning of year	7,164	(5,620)	1,544	(1,607)	(63)	(165)	(228)
Current service cost		(29)	(29)		(29)		(29)
Past service cost[note (vi)]		(106)	(106)		(106)		(106)
Net interest on net defined benefit liability (asset)	333	(264)	69	(70)	(1)	(8)	(9)
Administration expenses paid out of plan assets	(3)		(3)		(3)		(3)
Benefit payments	(239)	239	–		–		–
Employers' contributions[note (iv)]	71		71		71		71
Employees' contributions	2	(2)	–		–		–
Actuarial and other gains and losses[note (v)]	(131)	(277)	(408)	667	259	(20)	239
Transfer out of investment in Prudential insurance policies and other adjustments			–		–	24	24
Net surplus (deficit), end of year	7,197	(6,059)	1,138	(1,010)	128	(169)	(41)

C: Balance sheet notes continued

C9: Defined benefit pension schemes continued

Notes

(i) The IAS 19 basis pensions deficit can be summarised as follows:

	2013 £m			2012 £m		
	Quoted prices in an active market	**Other**	**Total**	**Quoted prices in an active market**	**Other**	**Total**
Plan assets (IAS 19 basis before effect of IFRIC 14):						
Equities:						
UK	24	2	26	21	2	23
Overseas	305	14	319	232	17	249
Government	4,564	–	4,564	4,965	–	4,965
Corporate	781	12	793	521	8	529
Asset-backed securities	62	–	62	42	–	42
Derivatives	97	–	97	176	–	176
Properties	–	115	115	–	207	207
Other assets	527	184	711	494	220	714
Fair value of plan assets, end of year*	6,360	327	6,687	6,451	454	6,905
Present value of benefit obligation			(6,298)			(6,059)
			389			846
Effect of the application of IFRIC 14 for pension schemes:						
Derecognition of PSPS' surplus			(602)			(1,010)
Consolidation adjustment in respect of investment of PSPS in Prudential policies			143			123
Deficit recognised in the statement of financial position			(70)			(41)

* The IAS 19 basis plan assets at 31 December 2013 of £6,687 million (2012: £6,905 million) is different from the economic basis plan assets of £6,944 million (2012: £7,197 million) as shown above due to the exclusion of investment in Prudential insurance policies, which are eliminated on consolidation of £257 million (2012: £292 million) comprising £143 million for PSPS (2012: £123 million) and £114 million for the M&GGPS scheme (2012: £169 million).

None of the scheme assets included shares in Prudential plc or property occupied by the Prudential Group.

(ii) Maturity profile of the benefit obligations
The weighted average duration of the benefit obligations of the schemes is 18.2 years (2012: 18.1 years)
The following table provides an expected maturity analysis of the benefit obligations as at 31 December 2013:

	2013 £m						
	1 year or less	**After 1 year to 5 years**	**After 5 years to 10 years**	**After 10 years to 15 years**	**After 15 years to 20 years**	**Over 20 years**	**Total**
All schemes	223	972	1,459	1,672	1,747	10,198	16,271

The expected maturity analysis of the benefit obligations as at 31 December 2012 is similar to those of 2013 above.

(iii) The adjustments for investments in Prudential insurance policies are consolidation adjustments for intragroup assets and liabilities with no impact to operating results.

(iv) Total employer contributions expected to be paid into the Group defined benefit schemes for the year ending 31 December 2014 amounts to £56 million (2013: £56 million).

(v) The actuarial and other gains and losses attributable to policyholders and shareholders as shown in the table above are analysed as follows:

	2013 £m	2012 £m
Actuarial and other gains and losses		
Return on the scheme assets less amount included in interest income	(366)	(131)
(Losses) gains on changes in demographic assumptions	(22)	14
Losses on changes in financial assumptions	(174)	(287)
Experience losses on scheme liabilities	(1)	(4)
	(563)	(408)
Effect of derecognition of PSPS surplus	447	667
Consolidation adjustment for investments in Prudential insurance policies and other adjustments	1	(20)
	(115)	239

(vi) During the first half of 2012, an exceptional discretionary increase to pensions in payment of PSPS was awarded which resulted in a past service cost of £106 million on the underlying surplus.

d Sensitivity of the pension scheme liabilities to key variables

The total underlying Group pension scheme liabilities of £6,298 million (2012: £6,059 million) comprise £5,316 million (2012: £5,226 million) for PSPS and £982 million (2012: £833 million) for the other schemes. The table below shows the sensitivity of the underlying PSPS and the other scheme liabilities at 31 December 2013 and 2012 to changes in discount rate, inflation rates and mortality rates. The sensitivity information below is based on the core scheme liabilities and assumptions at the balance sheet date. The sensitivity is calculated based on a change in one assumption, with all other assumptions being held constant. As such, interdependencies between the assumptions are excluded.

The sensitivity of the underlying pension scheme liabilities to changes in discount, inflation and mortality rates as shown above does not directly equate to the impact on the profit or loss attributable to shareholders or shareholders' equity, due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund as described above.

The sensitivity to the changes in the key variables as shown in the table above has no significant impact on the pension costs included in the Group's operating results. This is due to the pension costs charged in each of the periods presented, being derived largely from market conditions at the beginning of the period. After applying IFRIC 14 and to the extent attributable to shareholders, any residual impact from the changes to these variables is reflected as actuarial gains and losses on defined benefit pension schemes within the supplementary analysis of profits.

	Assumption applied		Sensitivity change in assumption	Impact of sensitivity on scheme liabilities on IAS 19 basis	2013	2012
	2013	2012				
Discount rate	4.4%	4.4%	Decrease by 0.2%	Increase in scheme liabilities by:		
				PSPS	3.3%	3.3%
				Other schemes	5.1%	4.9%
Discount rate	4.4%	4.4%	Increase by 0.2%	Decrease in scheme liabilities by:		
				PSPS	3.1%	3.1%
				Other schemes	4.7%	4.6%
Rate of inflation	RPI: 3.3%	RPI: 2.7%	RPI: Decrease by 0.2%	Decrease in scheme liabilities by:		
	CPI: 2.3%	CPI: 2.0%	CPI: Decrease by 0.2% with consequent reduction in salary increases	PSPS	0.7%	0.6%
				Other schemes	4.6%	4.3%
Mortality rate			Increase life expectancy by 1 year	Increase in scheme liabilities by:		
				PSPS	2.7%	2.6%
				Other schemes	2.7%	2.4%

C10: Share capital, share premium and own shares

	2013			2012		
	Number of ordinary shares	Share capital £m	Share premium £m	Number of ordinary shares	Share capital £m	Share premium £m
Issued shares of 5p each fully paid:						
At 1 January	2,557,242,352	128	1,889	2,548,039,330	127	1,873
Shares issued under share-based schemes	3,139,384	–	6	9,203,022	1	16
At 31 December	2,560,381,736	128	1,895	2,557,242,352	128	1,889

Amounts recorded in share capital represent the nominal value of the shares issued. The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued is credited to the share premium account.

At 31 December 2013, there were options outstanding under Save As You Earn schemes to subscribe for shares as follows:

	Number of shares to subscribe for	Share price range from	Share price range to	Exercisable by year
31 December 2013	10,233,986	288p	901p	2019
31 December 2012	9,396,810	288p	629p	2018

C: Balance sheet notes continued

C10: Share capital, share premium and own shares

Transactions by Prudential plc and its subsidiaries in Prudential plc shares

The Group buys and sells Prudential plc ('own shares') either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £141 million as at 31 December 2013 (2012: £97 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 31 December 2013, 7.1 million (2012: 8.0 million) Prudential plc shares with a market value of £94.5 million (2012: £69 million) were held in such trusts all of which are for employee incentive plans.

The Company purchased the following number of shares in respect of employee incentive plans.

	Number of shares purchased (in millions)*	Cost £m
2013	4.4	53.8
2012	5.9	47.9

* The maximum number of shares held in 2013 was 8.0 million which was in January 2013.

The shares purchased each month are as follows:

	2013 Share Price				2012 Share Price			
	Number of shares	Low £	High £	Cost £	Number of shares	Low £	High £	Cost £
January	11,864	9.15	9.15	108,496	15,573	6.40	6.40	99,589
February	10,900	9.25	9.25	100,868	12,678	7.33	7.33	92,930
March*	11,342	10.15	10.15	115,121	522,002	7.10	8.03	3,946,335
April	894,567	10.30	10.86	9,692,613	368,901	7.27	7.67	2,712,460
May	54,781	11.56	11.72	643,608	939,541	6.80	7.26	6,407,556
June	15,950	10.89	11.11	176,139	482,377	6.61	6.84	3,208,338
July	11,385	11.20	11.20	135,132	15,047	7.26	7.26	109,166
August	924,499	11.48	11.94	10,955,609	28,488	7.88	8.12	228,176
September	10,960	11.38	11.38	124,725	712,649	8.16	8.25	5,829,154
October	103,999	11.54	11.69	1,201,870	12,549	8.39	8.39	105,329
November	12,108	12.52	12.65	151,773	492,993	8.55	9.15	4,502,129
December	2,362,435	12.63	12.93	30,377,986	2,277,012	8.86	9.27	20,706,597
Total	4,424,790			53,783,940	5,879,810			47,947,759

* The 2012 comparative has been adjusted from previously published numbers.

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 31 December 2013 was 7.1 million (2012: 4.5 million) and the cost of acquiring these shares of £60 million (2012: £27 million) is included in the cost of own shares. The market value of these shares as at 31 December 2013 was £95 million (2012: £39 million). During 2013, these funds made net additions of 2,629,816 Prudential shares (2012: net disposals of 4,143,340) for a net increase of £33.1 million to book cost (2012: net decrease of £25.1 million).

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during 2013 or 2012.

C11: Capital position statement

This statement sets out the estimated capital position of the Group's subsidiaries, by life assurance and asset management operations by reference to the local regulations as at 31 December 2013.

C11.1 Life assurance business

a Summary statement

The Group's estimated capital position for its life assurance subsidiaries with reconciliations to shareholders' equity is shown below. In addition the statement provide an analysis of available capital for Group's life assurance operations, determined by reference to the local regulations, to meet risks and regulatory requirements.

	2013 £m							2012 £m
	SAIF	WPSF note (i)	Total PAC with-profits fund	Other UK life assurance subsidiaries and funds note (ii)	Jackson	Asia life assurance subsidiaries	Total life assurance operations note (b)	Total life assurance operations
Group shareholders' equity								
Held outside long-term funds:								
Net assets	–	–	–	912	3,446	2,564	6,922	7,553
Goodwill	–	–	–	–	–	231	231	239
Total	–	–	–	912	3,446	2,795	7,153	7,792
Held in long-term funds note (iii)	–	–	–	2,064	–	–	2,064	2,087
Total Group shareholders' equity	–	–	–	2,976	3,446	2,795	9,217	9,879
Adjustments to regulatory basis								
Unallocated surplus of with-profits funds note (v)	–	11,984	11,984	–	–	77	12,061	10,589
Shareholders' share of realistic liabilities	–	(3,112)	(3,112)	–	–	–	(3,112)	(2,469)
Deferred acquisition costs of non-participating business and goodwill not recognised for regulatory reporting	–	(5)	(5)	(89)	(4,121)	(784)	(4,999)	(4,201)
Jackson surplus notes note (iv)	–	–	–	–	151	–	151	153
Investment and policyholder liabilities valuation differences between IFRS and regulatory basis for Jackson note (vii)	–	–	–	–	2,610	–	2,610	696
Pension liability difference between IAS 19 and regulatory basis note (vii)	–	(55)	(55)	–	–	–	(55)	(107)
Valuation difference on PAL between IFRS basis and regulatory basis	–	(195)	(195)	–	–	–	(195)	(215)
Other adjustments note (v)	–	(617)	(617)	(179)	817	(286)	(265)	(435)
Total adjustments	–	8,000	8,000	(268)	(543)	(993)	6,196	4,011
Total available capital resources of life assurance businesses on local regulatory bases	–	8,000	8,000	2,708	2,903	1,802	15,413	13,890
Policyholder liabilities								
UK regulated with-profits funds:								
Insurance contracts	6,428	28,735	35,163	–	–	6,293	41,456	43,266
Investment contracts with discretionary participation features	374	34,978	35,352	–	–	101	35,453	33,559
Total	6,802	63,713	70,515	–	–	6,394	76,909	76,825
Other liabilities:								
Insurance contracts:								
With-profits liabilities of non-UK regulated funds	–	–	–	–	–	6,744	6,744	6,597
Unit-linked, including variable annuity note (viii)	–	32	32	6,127	65,681	11,918	83,758	67,382
Other life assurance business note (viii)	310	12,973	13,283	27,069	39,290	6,724	86,366	88,492
Investment contracts without discretionary participation features note (vi)	–	23	23	17,583	2,440	130	20,176	18,378
Total	310	13,028	13,338	50,779	107,411	25,516	197,044	180,849
Total policyholder liabilities shown in the consolidated statement of financial position	7,112	76,741	83,853	50,779	107,411	31,910	273,953	257,674

C: Balance sheet notes continued

C11: Capital position statement continued

Notes

(i) WPSF unallocated surplus includes amounts related to the Hong Kong branch. Policyholder liabilities are included in the Asia life assurance subsidiaries.
(ii) Excluding PAC shareholders' equity that is included in 'parent company and shareholders' equity of other subsidiaries and funds'.
(iii) The term shareholders' equity held in long-term funds refers to the excess of assets over liabilities attributable to shareholders of funds which are required by law to be maintained ring-fenced with segregated assets and liabilities.
(iv) For regulatory purposes the Jackson surplus notes are accounted for as capital.
(v) Other adjustments to shareholders' equity and unallocated surplus include amounts for the value of non-participating business for UK regulated with-profits funds, deferred tax, admissibility and other items measured differently on the regulatory basis. For Jackson the principal reconciling item is deferred tax related to the differences between IFRS and regulatory basis as shown in the table above and other methodology differences.
(vi) Principally includes unit-linked and similar contracts in the UK and GIC liabilities of Jackson.
(vii) The investment and policyholder liabilities valuation difference between IFRS and regulatory bases for Jackson is mainly due to not all investments being carried at fair value under the regulatory basis and also due to the valuation difference on annuity reserves.
(viii) The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

b Reconciliation to the Group total shareholders' equity

The table below reconciles shareholders' equity held in life assurance operations (as shown in the table in note (a)) to the Group total shareholders' equity as at 31 December 2013:

	2013 £m			
	Total life assurance operations	**M&G (including Prudential Capital)**	**Parent company and shareholders' equity of other subsidiaries and funds** note (i)	**Group total**
Group shareholders' equity				
Held outside long-term funds:				
Net assets	6,922	449	(1,246)	6,125
Goodwill	231	1,153	77	1,461
Total	7,153	1,602	(1,169)	7,586
Held in long-term funds	2,064	–	–	2,064
Total Group shareholders' equity	9,217	1,602	(1,169)	9,650

Note

(i) Including PAC shareholders' equity.

c Movement in total available capital

Total available capital for the Group's life assurance operations has changed as follows:

	£m				
	WPSF note (i)	**Other UK life assurance subsidiaries and funds** note (iii)	**Jackson** note (ii)	**Asia life assurance subsidiaries** note (iv)	**Group total**
Available capital at 31 December 2012	7,000	2,370	2,899	1,621	13,890
Changes in assumptions	200	122	–	34	356
Changes in management policy	(100)	–	–	–	(100)
Changes in regulatory requirements	600	–	–	(23)	577
New business and other factors note (v)	300	216	4	170	690
Available capital at 31 December 2013	8,000	2,708	2,903	1,802	15,413

Notes

(i) With-profits sub-fund
The increase in 2013 of £1 billion reflects primarily the positive impact of investment returns earned on the opening available capital and rising yields.
(ii) Jackson
The increase of £4 million in 2013 reflects an underlying increase of £57 million (applying the 2013 year end exchange rate of US$1.66:£1.00) and £53 million of exchange translation loss.
(iii) Other UK life assurance subsidiaries and funds
The effect from the changes in assumptions of valuation interest rates on insurance liabilities is broadly matched by the corresponding effect on assets leaving no significant impact on the available capital.
(iv) Asia life assurance subsidiaries
The increase of £181 million in 2013 reflects an underlying increase of £325 million (applying the relevant 2013 year end exchange rates) and £143 million of exchange translation loss.
(v) New business and other factors comprise the effect of changes in new business, valuation interest rate, investment return, foreign exchange and other factors.

d Basis of preparation, capital requirements and management

Each of the Group's long-term business operations is capitalised to a sufficiently strong level for its individual circumstances. Details by the Group's major operations are shown below.

i Asia insurance operations

The available capital shown above of £1,802 million (2012: £1,621 million) represents the excess of local regulatory basis assets over liabilities before deduction of required capital of £699 million (2012: £661 million).

The businesses in Asia are subject to local capital requirements in the jurisdictions in which they operate. The Hong Kong business branch of PAC and its capital requirements are subsumed within those of the PAC long-term fund. The Hong Kong business branch of PAC was transferred to separate subsidiaries established in Hong Kong on 1 January 2014 (see note D2). For the other material Asian operations, the details of the basis of determining regulatory capital and regulatory capital requirements are as follows:

Indonesia

Solvency capital is determined using a risk-based capital approach. Insurance companies in Indonesia are expected to maintain the level of net assets above 120 per cent of solvency capital.

In 2013, the local regulatory basis in Indonesia was replaced with the Indonesian authority's risk-based capital framework. In accordance with the framework, policy reserves for traditional business are determined on a gross premium reserve basis using prudent best estimate assumptions. For linked business, the value of the units are maintained with a non-unit reserve which is calculated in accordance with standard actuarial methodology.

Korea

Policy reserves for traditional business are determined on net premium reserve basis using standard mortality and prescribed standard interest rates.

For linked business, the value of the units are held together with the non-unit reserves and calculated in accordance with the local regulator's standard actuarial methodology.

A risk-based capital framework is applied in Korea. For local solvency, the regulatory minimum is 100 per cent of the risk-based capital. Further, in accordance with the local risk-based capital framework, insurers are expected to maintain a level of free surplus in excess of the capital requirements. The general target level for the solvency margin is greater than 150 per cent of the risk-based capital as required by the regulators.

Malaysia

A risk-based capital framework applies in Malaysia.

For participating business, a gross premium reserve on the guaranteed and non-guaranteed benefits determined using best estimate assumptions is held. The amount held is subject to a minimum of a gross premium reserve on the guaranteed benefits, determined using best estimate assumptions along with provisions of risk margin for adverse deviations discounted at the risk-free rate.

For non-participating business, gross premium reserves determined using best estimate assumptions along with provisions of risk margin for adverse deviations discounted at the risk-free rate are held. For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology.

Participating fund surplus is not allowed to be used to support a deficit (if any) and the capital requirement of the non-participating business. The capital requirement is calculated based on a prescribed series of risk charges. The local regulator has set a Supervisory Target Capital Level of 130 per cent below which supervisory actions of increasing intensity will be taken. Each insurer is also required to set its own Individual Target Capital Level to reflect its own risk profile and this is expected to be higher than the Supervisory Target Capital Level.

Singapore

A risk-based regulatory framework applies in Singapore.

For participating business, a gross premium reserve, determined using prudent best estimate assumptions and which makes allowance for future bonus, is held. The amount held is subject to a minimum of the higher of the assets attributed to participating business and a gross premium reserve calculated on specified assumptions, but without allowance for future bonus, that include prescribed provisions for adverse deviations (PADs).

For non-participating business, gross premium reserves are held. For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology.

C: Balance sheet notes continued

C11: Capital position statement continued

Thailand

A new risk-based capital framework was adopted from 1 January 2012 to replace the previous framework that used a net premium approach.

For non-participating business, the gross premium reserves are determined using best estimate assumptions along with provisions of risk margin for adverse deviations discounted at the risk-free rate.

The risk free rate is derived from the greater of the current yield curve of Thai government bonds or a weighted-average yield curve of the prior seven quarters Thai government bonds, as prescribed by the local regulator.

Vietnam

For traditional business, mathematical reserves are calculated using a modified net premium approach, set using assumptions agreed with the regulator.

For linked business, the value of units is held together with the non-unit reserves calculated in accordance with the local regulator's standard actuarial methodology.

The capital requirement is determined as 4 per cent of reserves plus a specified percentage of 0.1 per cent of sums at risk for policies with original term less than or equal to five years or 0.3 per cent of sums at risk for policies with original term of more than five years. An additional capital requirement of Vietnamese Dong 200 billion is also required for companies transacting unit-linked business.

ii US insurance operations

The regulatory framework for Jackson is governed by the requirements of the US NAIC approved risk-based capital standards. Under these requirements life insurance companies report using a formula-based capital standard that they calculate by applying factors to various asset, premium and reserve items and separate model based calculations of risk associated primarily with variable annuity products. The risk-based capital formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk, market risk and business risk.

The available capital of Jackson shown above of £2,903 million (2012: £2,899 million) reflects US regulatory basis assets less liabilities as adjusted for asset valuation reserves. The asset valuation reserve, which is reflected as available capital, is designed to provide for future credit-related losses on debt securities and losses on equity investments. Available capital includes a reduction for the effect of the interest maintenance reserve, which is designed by state regulators to defer recognition of non-credit related realised capital gains and losses and to recognise them ratably in the future.

Jackson's risk-based capital ratio is significantly in excess of regulatory requirements. At 31 December 2013, Jackson had a permitted practice in effect as granted by the local regulator allowing Jackson to carry certain interest rate swaps at book value, as if statutory hedge accounting were in place, instead of at fair value as would have been otherwise required. Jackson was also required to demonstrate the effectiveness of its interest rate swap programme pursuant to the Michigan Insurance Code. The total effect of this permitted practice net of tax was to increase statutory surplus by £0.8 million at 31 December 2013.

Michigan insurance law specifically allows value of business acquired as an admitted asset as long as certain criteria are met. US NAIC standards limit the admitted amount of goodwill/value of business acquired generally to 10 per cent of capital and surplus. At 31 December 2013, Jackson reported £257 million of statutory basis value of business acquired as a result of the REALIC acquisition, which is fully admissible under Michigan insurance law.

iii UK insurance operations

In the UK, the insurers, regulated by PRA, must hold capital resources equal at least to the Minimum Capital Requirement (MCR). In addition the rules require insurers to perform Individual Capital Assessments. Under these rules insurers must assess for themselves the amount of capital needed to back their business. If the PRA views the results of this assessment as insufficient, it may draw up its own Individual Capital Guidance for a firm, which can be superimposed as a requirement.

PAC with-profits sub-fund and Scottish Amicable Insurance Fund

Under PRA rules, insurers with with-profits liabilities of more than £500 million must hold capital equal to the higher of the MCR and the Enhanced Capital Requirement (ECR). The ECR is intended to provide a more risk responsive and 'realistic' measure of a with-profit insurer's capital requirements, whereas the MCR is broadly speaking equivalent to the previous required minimum margin under the Interim Prudential Sourcebook and satisfies the minimum EU Standards.

Determination of the ECR involves the comparison of two separate measurements of the firm's resources requirement, which the PRA refers to as the 'twin peaks' approach.

The two separate peaks are:

i The requirement comprised by the mathematical reserves plus the 'Long-Term Insurance Capital Requirement' (LTICR), together known as the 'regulatory peak'; and

ii A calculation of the 'realistic' present value of the insurer's expected future contractual liabilities together with projected 'fair' discretionary bonuses to policyholders, plus a risk capital margin, together known as the 'realistic peak'.

Available capital of the with-profits sub-fund and Scottish Amicable Insurance Fund of £8.0 billion (2012: £7.0 billion) represents the excess of assets over liabilities on the PRA realistic basis. Unlike the previously discussed FRS 27 basis, realistic liabilities on the regulatory basis include the shareholders' share of future bonuses. These amounts are shown before deduction of the risk capital margin which is estimated to be £0.9 billion at 31 December 2013 (2012: £1.5 billion).

The PRA's basis of setting the risk capital margin is to target a level broadly equivalent to a Standard & Poor's credit rating of BBB and to judge this by ensuring there are sufficient assets to absorb a one in 200 year event. The risk capital margin calculation achieves this by setting rules for the determination of margins to cover defined stress changes in asset values and yields for market risk, credit risk and termination risk for with-profits policies.

PAC has discretion in its management actions in the case of adverse investment conditions. Management actions encompass, but are not confined to, investment allocation decisions, levels of reversionary bonuses, crediting rates and total claim values.

Other UK life assurance subsidiaries and funds

The available capital of £2,708 million (2012: £2,370 million) reflects the excess of regulatory basis assets over liabilities of the subsidiaries and funds, before deduction of the capital resources requirement of £1,364 million (2012: £1,376 million).

The capital resources requirement for these companies broadly reflects a formula which, for active funds, equates to a percentage of regulatory reserves plus a percentage of death strains. Death strains represent the payments made to policyholders upon death in excess of amounts explicitly allocated to fund the provisions for policyholder's claims and maturities.

iv Group capital requirements

In addition to the requirements at individual company level, PRA requirements under the IGD apply additional prudential requirements for the Group as a whole. Discussion of the Group's estimated IGD position at 31 December 2013, together with market risk sensitivity disclosure provided to key management, is provided in the Strategic Report section of the Group's 2013 Annual Report.

e Transferability of available capital

For PAC and all other UK long-term insurers, long-term business assets and liabilities must, by law, be maintained in funds separate from those for the assets and liabilities attributable to non-life insurance business or to shareholders. Only the 'established surplus', the excess of assets over liabilities in the long-term fund determined through a formal valuation, may be transferred so as to be available for other purposes. Distributions from the with-profits sub-fund to shareholders reflect the shareholders' one-ninth share of the cost of declared policyholders' bonuses.

Accordingly, the excess of assets over liabilities of the PAC long-term fund is retained within that company. The retention of the capital enables it to support with-profits and other business of the fund by, for example, providing the benefits associated with smoothing and guarantees. It also provides investment flexibility for the fund's assets by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus and investment policies.

For other UK long-term business subsidiaries, the amounts retained within the companies are at levels which provide an appropriate level of capital strength in excess of the regulatory minimum.

For Jackson, capital retention is maintained at a level consistent with an appropriate rating by Standard & Poor's. Currently Jackson is rated AA. Jackson can pay dividends on its capital stock only out of earned surplus unless prior regulatory approval is obtained. Furthermore, dividends which exceed the greater of statutory net gain from operations for the prior year or 10 per cent of Jackson's prior year-end statutory surplus require prior regulatory approval.

For Asian subsidiaries, the amounts retained within the companies are at levels that provide an appropriate level of capital strength in excess of the local regulatory minimum. For ring-fenced with-profits funds, the excess of assets over liabilities is retained with distribution tied to the shareholders' share of bonuses through declaration of actuarially determined surplus. The Singapore and Malaysian businesses may, in general, remit dividends to the UK, provided the statutory insurance fund meets the capital adequacy standard required under local statutory regulations.

Available capital of the non-insurance business units is transferable to the life assurance businesses after taking account of an appropriate level of operating capital, based on local regulatory solvency targets, over and above basis liabilities.

C: Balance sheet notes continued

C11: Capital position statement continued

f Sensitivity of liabilities and total capital to changed market conditions and capital management policies

Prudential manages its assets, liabilities and capital locally, in accordance with local regulatory requirements and reflecting the different types of liabilities Prudential has in each business. As a result of the diversity of products offered by Prudential and the different regulatory requirements in which it operates, Prudential employs differing methods of asset/liability and capital management, depending on the business concerned.

Stochastic modelling of assets and liabilities is undertaken in the UK, Jackson and Asia to assess the economic capital requirements. A stochastic approach models the inter-relationship between asset and liability movements, taking into account asset correlation, management actions and policyholder behaviour under a large number of alternative economic scenarios.

In addition, reserve adequacy testing under a range of scenarios and dynamic solvency testing is carried out, including under certain scenarios mandated by the UK, US and Asian regulators.

The sensitivity of liabilities and other components of total capital vary depending upon the type of business concerned and this conditions the approach to asset/liability management.

For example, for businesses that are most sensitive to interest rate changes, such as immediate annuity business, Prudential uses cash flow analysis to create a portfolio of debt securities whose value changes in line with the value of liabilities when interest rates change. This type of analysis helps protect profits from changing interest rates. This type of analysis is used in the UK for annuity business and by Jackson for its interest-sensitive and fixed index annuities and institutional products.

For businesses that are most sensitive to equity price changes, Prudential uses stochastic modelling and scenario testing to look at the future returns on its investments under different scenarios which best reflect the large diversity in returns that equities can produce. This allows Prudential to devise an investment and with-profits policyholder bonus strategy that, based on the model assumptions, allows it to optimise returns to its policyholders and shareholders over time while maintaining appropriate financial strength. Prudential uses this methodology extensively in connection with its UK with-profits business.

g Intra-group arrangements in respect of the Scottish Amicable Insurance Fund

Should the assets of the Scottish Amicable Insurance Fund be inadequate to meet the guaranteed benefit obligations of the policyholders of the Scottish Amicable Insurance Fund, the PAC long-term fund would be liable to cover any such deficiency in the first instance.

C11.2 Asset management operations – Regulatory and other surplus

Certain asset management subsidiaries of the Group are subject to regulatory requirements. The movement in the year of the surplus regulatory capital position of those subsidiaries, combined with the movement in the IFRS basis shareholders' funds for unregulated asset management operations, is as follows:

	Asset management operations				
	2013 £m				2012 £m
	M&G including Prudential Capital	US	Eastspring Investments	Total	Total
Regulatory and other surplus					
Beginning of year	255	124	134	513	412
Gains during the year	349	18	57	424	416
Movement in capital requirement	(3)	–	(1)	(4)	3
Capital injection	–	–	8	8	9
Distributions made to the parent company	(292)	(6)	(67)	(365)	(318)
Exchange movement	–	(2)	(2)	(4)	(9)
End of year	309	134	129	572	513

C12: Provisions

	2013 £m	2012* £m
Provision in respect of defined benefit pension schemes:C9	194	205
Other provisions (see below)	441	386
Total provisions	635	591

Analysis of other provisions:

	2013 £m				2012* £m			
	Legal provisions note (i)	Restructuring provisions note (ii)	Other Provisions note (iii)	Total	Legal provisions note (i)	Restructuring provisions note (ii)	Other Provisions note (iii)	Total
At 1 January	20	27	339	386	14	23	252	289
Charged to income statement:								
Additional provisions	17	2	183	202	10	14	207	231
Unused amounts released	(2)	(13)	(10)	(25)	(1)	(4)	(7)	(12)
Used during the year	(21)	(3)	(86)	(110)	(2)	(6)	(109)	(117)
Exchange differences	–	–	(12)	(12)	(1)	–	(4)	(5)
Total at 31 December	14	13	414	441	20	27	339	386

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Notes

(i) Total legal provisions at 31 December 2013 of £14 million related to Jackson. Jackson has been named in civil proceedings, which appear to be substantially similar to other class action litigation brought against many life insurers in the US, alleging misconduct in the sale of insurance products. Of the £14 million legal provision as at 31 December 2013, £11 million has been established to cover this potential litigation and is expected to be utilised over the next five years.

(ii) Restructuring provisions primarily relate to restructuring activities of UK insurance operations. The provisions pertain to property liabilities resulting from the closure of regional sales centres and branches and staff terminations and other transformation costs to enable streamlining of operations.

(iii) Other provisions comprise staff benefits provisions of £332 million, provisions for onerous contracts of £41 million and regulatory and other provisions of £41 million. Staff benefits are generally expected to be paid out within the next three years.

The provision balance is expected to be paid out within the next five years.

C: Balance sheet notes continued

C13: Property, plant and equipment

Property, plant and equipment comprise Group occupied properties and tangible assets. A reconciliation of the carrying amount of these items from the beginning of the year to the end of the year is as follows:

	2013 £m			2012* £m		
	Group occupied property	**Tangible assets**	**Total**	**Group occupied property**	**Tangible assets**	**Total**
At 1 January						
Cost	251	970	1,221	258	884	1,142
Accumulated depreciation	(39)	(428)	(467)	(29)	(376)	(405)
Net book amount	212	542	754	229	508	737
Year ended 31 December						
Opening net book amount	212	542	754	229	508	737
Exchange differences	(1)	(2)	(3)	(9)	(8)	(17)
Depreciation charge	(12)	(75)	(87)	(10)	(80)	(90)
Additions	96	125	221	4	135	139
Arising on acquisitions of subsidiaries	1	77	78	–	(1)	(1)
Disposals and transfers	11	(54)	(43)	(2)	(12)	(14)
Closing net book amount	307	613	920	212	542	754
At 31 December						
Cost	357	1,060	1,417	251	970	1,221
Accumulated depreciation	(50)	(447)	(497)	(39)	(428)	(467)
Net book amount	307	613	920	212	542	754

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

Capital expenditure: property, plant and equipment by segment

The capital expenditure of £125 million (2012: £135 million) arose as follows: £68 million in UK, £16 million in US and £23 million in Asia in insurance operations with the remaining balance of £18 million arising from asset management operations and unallocated corporate expenditure (2012: £80 million in UK, £24 million in US, £17 million in Asia in insurance operations and £10 million in other operations).

C14: Investment properties

Investment properties principally relate to the PAC with-profits fund and are carried at fair value. A reconciliation of the carrying amount of investment properties at the beginning and end of the year is set out below:

	2013 £m	2012* £m
At 1 January	10,554	10,470
Additions:		
Resulting from acquisitions	1,050	1,025
Resulting from expenditure capitalised	42	118
Disposals	(613)	(695)
Net gain (loss) from fair value adjustments	441	(215)
Net foreign exchange differences	(15)	(52)
Transfers from (to) held for sale assets	18	(97)
At 31 December	11,477	10,554

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note A2.

The 2013 income statement includes rental income from investment properties of £606 million (2012: £544 million) and direct operating expenses including repairs and maintenance arising from these properties of £46 million (2012: £49 million).

Investment properties of £4,426 million (2012: £3,845 million) are held under finance leases. A reconciliation between the total of future minimum lease payments at the statement of financial position date, and their present value is shown below. This table also shows the minimum future rentals to be received on non-cancellable operating leases of the Group's freehold investment properties in the following periods:

	2013 £m			2012* £m		
	Future minimum payments	Future finance charges	PV of future minimum payments	Future minimum payments	Future finance charges	PV of future minimum payments
Less than 1 year	5	–	5	5	–	5
1 to 5 years	19	(3)	16	22	(4)	18
Over 5 years	824	(752)	72	959	(873)	86
Total	848	(755)	93	986	(877)	109

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on the future value of a factor that changes other than with the passage of time. There was no contingent rent recognised as income or expense in 2013 and 2012.

The Group's policy is to rent investment properties to tenants through operating leases. Minimum future rentals to be received on non-cancellable operating leases of the Group's freehold investment properties are receivable in the following periods:

	2013 £m	2012 £m
Less than 1 year	351	451
1 to 5 years	1,204	1,541
Over 5 years	3,294	3,785
Total	4,849	5,777

The total minimum future rentals to be received on non-cancellable sub-leases for the Group's investment properties held under finance leases at 31 December 2013 are £2,315 million (2012: £2,439 million).