Chief Financial Officer's report on the 2017 financial performance – Mark FitzPatrick

Broad-based performance and strong growth in high quality business

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

Performance was broad-based across our business units led by our Asia businesses which delivered double digit growth in new business profit (up 12 per cent[1]), IFRS operating profit based on longer-term investment returns ('IFRS operating profit') (up 15 per cent[1]) and underlying free surplus generation[3] (up 19 per cent[1]). Asia achieved its 2017 financial objectives, demonstrating successful execution of its strategy, focusing on diversified recurring premium business, at scale. In the US, we saw good growth in fee income, driven by positive net inflows and favourable equity market conditions, which outweighed the expected reduction in the contribution from spread income.

During 2017 we combined M&G and our UK and Europe life business to form M&G Prudential. I am pleased to report that M&G Prudential asset management delivered record external net inflows of £17.3 billion, with overall assets under management[4] at a new high of £351 billion at the end of 2017. We are making good progress in delivering our merger and transformation programme, and remain on track to deliver our previously announced savings by the end of 2022.

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

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

The key financial highlights in 2017 were as follows:

- **New business profit** was 12 per cent higher at £3,616 million (17 per cent on an actual exchange rate basis), underpinned by higher volumes with **APE sales** up 6 per cent (10 per cent on an actual exchange rate basis). In Asia, new business profit increased 12 per cent primarily as a result of prioritisation of health and protection products and positive pricing actions. Jackson's new business profit increased by 9 per cent, including the benefit of US tax reform. UK life new business profit grew by 28 per cent, driven by a 29 per cent increase in APE sales, supported by consumer demand for products offering access to our PruFund investment option.
- **Asset management net inflows** reached record levels, with M&G Prudential asset management reporting external net inflows of £17.3 billion (2016: net outflows of £8.1 billion) reflecting growth across its wholesale/direct and institutional businesses, and Eastspring delivering external net inflows of £3.1 billion (excluding money market funds) (2016: £1.8 billion on an actual exchange rate basis).
- **IFRS operating profit based on longer-term investment returns** was 6 per cent higher at £4,699 million (10 per cent higher on an actual exchange rate basis). IFRS operating profit from our Asia business grew by 15 per cent to £1,975 million, reflecting continued business momentum. In the US, IFRS operating profit increased by 3 per cent, reflecting mainly growth in fee income on higher asset balances, which outweighed the anticipated reduction in spread earnings. In the UK, M&G Prudential's total IFRS operating profit was 10 per cent higher than the prior year reflecting 6 per cent growth in the insurance business, with core[5] life operating profit stable at £597 million, and record asset management profit of £500 million resulting from the positive impact on earnings of net fund inflows, supportive markets and higher performance fees.
- **Total IFRS post tax profit** was up 21 per cent at £2,390 million (24 per cent on an actual exchange rate basis) and total EEV after-tax profit was 87 per cent higher at £8,751 million (94 per cent on an actual exchange rate basis). Total profit includes the impact of short-term fluctuations in financial assets held to back the commitments that we have made to our customers, and the related liabilities, and are reported outside the operating result which is based on longer-term investment return assumptions. In 2017 these principally arose within Jackson as discussed later in my report. Total profit after-tax includes the impact of the US tax reform, which generated an IFRS charge of £445 million from the re-measurement of US net deferred tax balances following the reduction in the corporate income tax rate and an EEV gain of £390 million which additionally includes the benefit of future profits being taxed at a lower rate. Reflecting this post tax profit, **Group IFRS shareholders'** equity was 10 per cent higher at £16.1 billion. Similarly, EEV basis shareholders' equity was up 15 per cent at £44.7 billion.

— **Underlying free surplus generation**[2,3], our preferred measure of cash generation, from our life and asset management businesses, decreased by 1 per cent to £3,640 million (up 2 per cent on an actual exchange rate basis), after financing new business growth. Increased contributions from our Asia and UK businesses were balanced by a lower contribution from our US business primarily as a result of non-recurrence of a transaction undertaken in 2016 to enhance local capital efficiency. We continue to focus on high-return new business with fast payback periods.

— **Group shareholders' Solvency II capital surplus**[6] was estimated at £13.3 billion at 31 December 2017, equivalent to a cover ratio of 202 per cent[7] (1 January 2017: £12.5 billion, 201 per cent). The improvement in the period reflects the continuing strength of the Group's operating capital generation in excess of growing dividend payments to shareholders.

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

IFRS profit[2]

	Actual exchange rate			Constant exchange rate	
	2017 £m	**2016** £m	**Change** %	**2016** £m	**Change** %
Operating profit before tax based on longer-term investment returns					
Asia					
Long-term business	1,799	1,503	20	1,571	15
Asset management	176	141	25	149	18
Total	1,975	1,644	20	1,720	15
US					
Long-term business	2,214	2,052	8	2,156	3
Asset management	10	(4)	350	(4)	350
Total	2,224	2,048	9	2,152	3
UK and Europe					
Long-term business	861	799	8	799	8
General insurance commission	17	29	(41)	29	(41)
Total insurance operations	878	828	6	828	6
Asset management	500	425	18	425	18
Total	1,378	1,253	10	1,253	10
Other income and expenditure[8]	(775)	(694)	(12)	(700)	(11)
Total operating profit based on longer-term investment returns before tax, restructuring costs and interest received from tax settlement	4,802	4,251	13	4,425	9
Restructuring costs	(103)	(38)	(171)	(39)	(164)
Interest received from tax settlement	–	43	n/a	43	n/a
Total operating profit based on longer-term investment returns before tax	4,699	4,256	10	4,429	6
Non-operating items:					
Short-term fluctuations in investment returns on shareholder-backed business	(1,563)	(1,678)	7	(1,764)	11
Amortisation of acquisition accounting adjustments	(63)	(76)	17	(79)	20
Profit (loss) attaching to disposal of businesses	223	(227)	n/a	(244)	n/a
Profit before tax	3,296	2,275	45	2,342	41
Tax charge attributable to shareholders' returns	(906)	(354)	(156)	(360)	(152)
Profit for the year	2,390	1,921	24	1,982	21

IFRS earnings per share

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

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

Asia total operating profit of £1,975 million was 15 per cent higher than the previous year (20 per cent on an actual exchange rate basis). IFRS operating profit from life insurance operations increased 15 per cent to £1,799 million (20 per cent on an actual exchange rate basis), reflecting the continued growth of our in-force book of recurring premium business, with renewal insurance premiums[9] reaching £11.6 billion (2016: £9.5 billion on a constant exchange rate basis). Insurance margin was up 21 per cent, reflecting our continued focus on health and protection business. At a country level, we have seen improvement in all of our markets, with double-digit growth in IFRS operating profit in eight out of 12, led by Hong Kong and China (both increasing 38 per cent). Including money market funds and the assets managed for internal life operations, Eastspring's total assets under management increased to £138.9 billion (2016: £117.9 billion on an actual exchange rate basis), while the cost-income ratio was stable at 56 per cent (2016: 56 per cent), driving an 18 per cent increase in IFRS operating profit to £176 million (2016: £149 million).

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

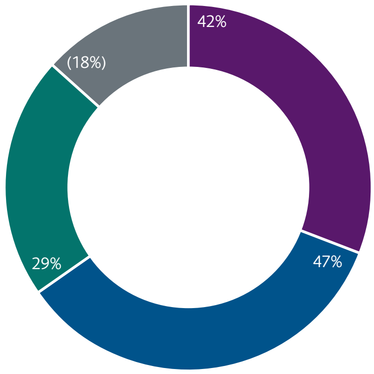
UK and Europe total operating profit was 10 per cent[2] higher at £1,378 million. Life insurance IFRS operating profit increased by 8 per cent to £861 million (2016: £799 million). Within this total, the contribution from our core[5] with-profits and in-force annuity business was £597 million (2016: £601 million), including an increased transfer to shareholders from the with-profits funds of £288 million (2016: £269 million) of which 15 per cent was from PruFund business (2016: 10 per cent). The balance of the life insurance result reflects the contribution from other activities which are not expected to recur to the same extent going forward. This includes, as anticipated, lower IFRS operating profit from the sale of annuities of £9 million (2016: £41 million) and a number of other items discussed below. Asset management IFRS operating profit increased 18 per cent to £500 million, driven by higher average assets under management and improved performance fees, together with a lower cost-income ratio of 58 per cent (2016: 59 per cent).

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

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

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

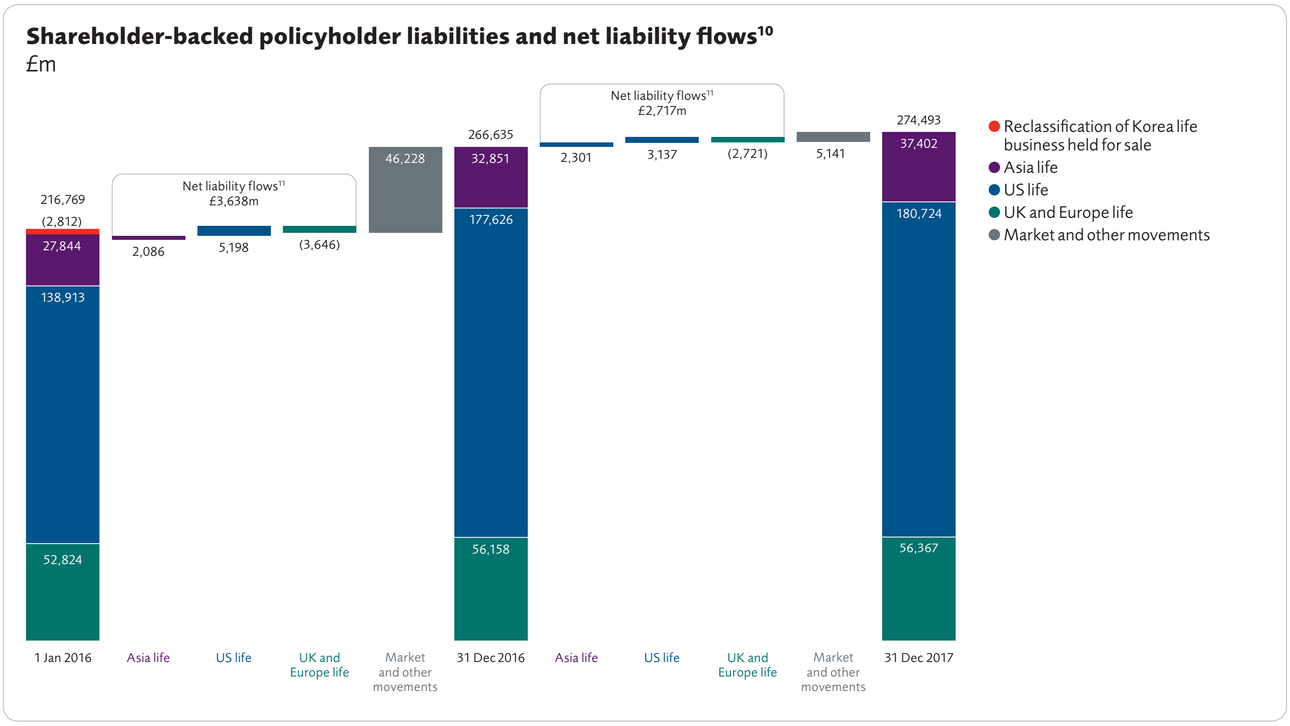
IFRS operating profit by business[2]
£m (% vs 2016)



£4,699m
+6% (+10% AER)

- Asia £1,975m, +15% (+20% AER)
- US £2,224m, +3% (+9% AER)
- UK and Europe £1,378m, +10%
- Others[8] £(878)m, -26%

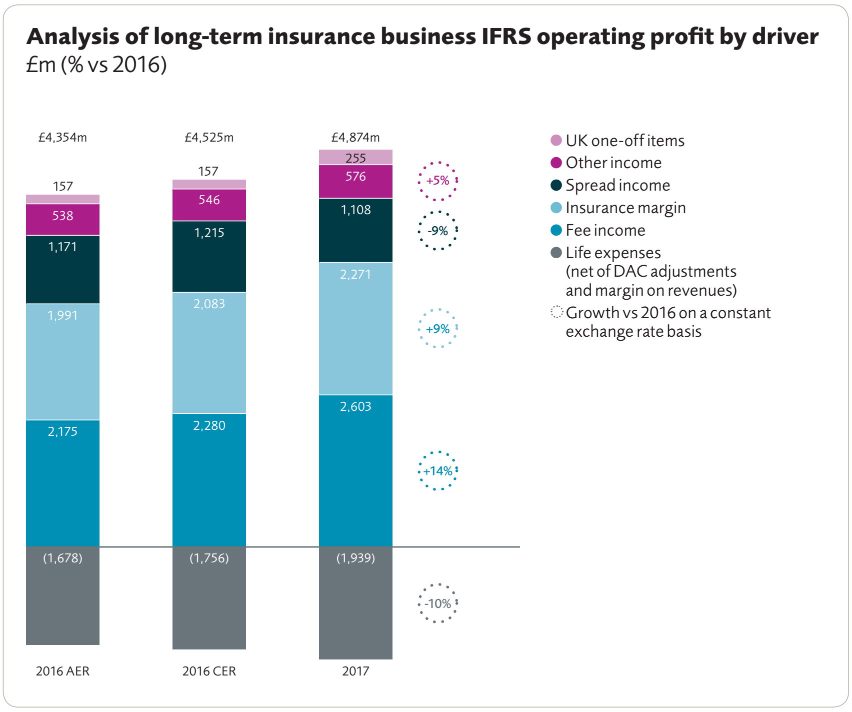
Chief Financial Officer's report on the 2017 financial performance – Mark FitzPatrick continued



Policyholder liabilities and net liability flows in with-profits business[10,12]

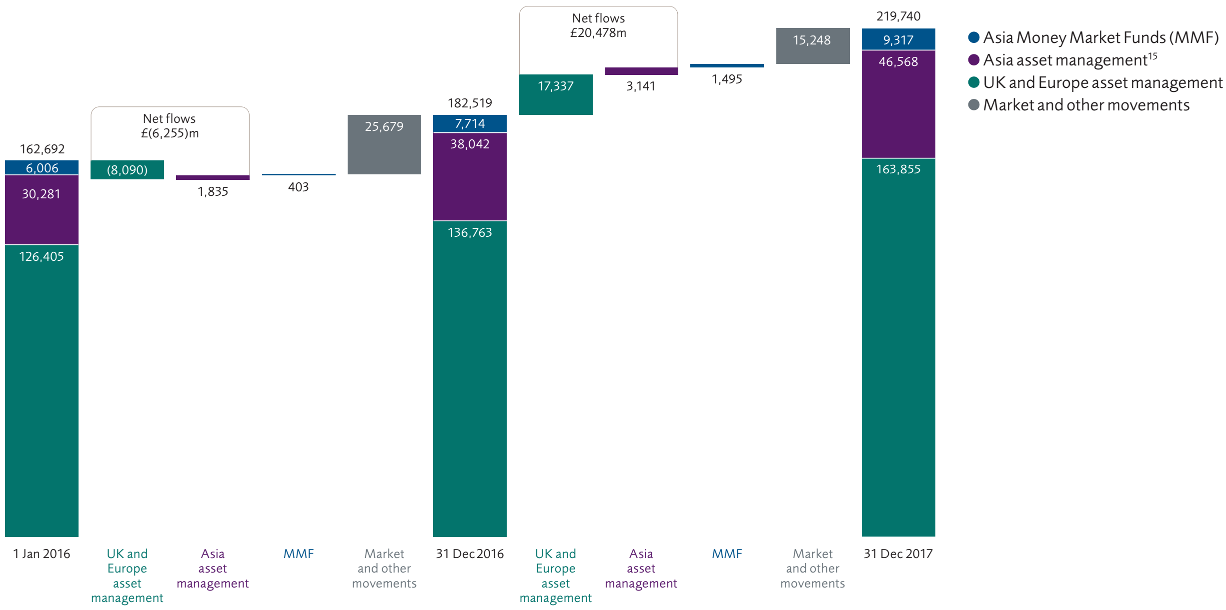
	2017 £m				2016 £m			
	Actual exchange rate				Actual exchange rate			
	At 1 January	Net liability flows[11]	Market and other movements	At 31 December	At 1 January	Net liability flows[11]	Market and other movements	At 31 December
Asia	29,933	4,574	1,930	36,437	20,934	3,696	5,303	29,933
UK and Europe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

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



Asset management external net flows and external funds under management[13,14]

£m



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

Asset management profit drivers

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

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

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

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

Other income and expenditure and restructuring costs[8]

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

IFRS non-operating items[8]

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

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

IFRS short-term fluctuations in investment returns on shareholder-backed business

IFRS operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns. In 2017, the total short-term fluctuations in investment returns on shareholder-backed business were negative £1,563 million and comprised negative £1 million for Asia, negative £1,568 million in the US, negative £14 million in the UK and positive £20 million in other operations.

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

IFRS effective tax rates

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

The 2017 effective tax rate on the total IFRS profit was 27 per cent (2016: 16 per cent), reflecting the inclusion of a £445 million one-off charge on the re-measurement of US deferred tax balances using a rate of 21 per cent (previously 35 per cent) following the enactment in December 2017 of a comprehensive US tax reform package. Excluding this one-off charge, the 2017 effective tax rate would have been 14 per cent.

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

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

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

Total tax contribution

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

Tax strategy

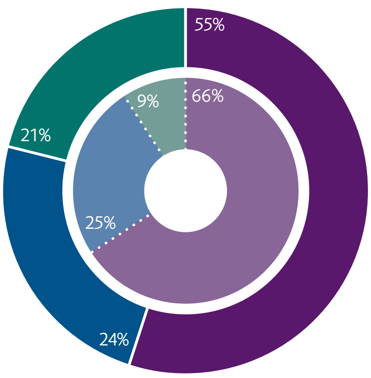
In May 2017 the Group published its tax strategy, which in addition to complying with the mandatory UK (Finance Act 2016) requirements, also included a number of additional disclosures, including a breakdown of revenues, profits and taxes for all jurisdictions where more than £5 million tax was paid.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

New business performance

Life EEV new business profit and APE new business sales (APE sales)

	Actual exchange rate						Constant exchange rate			
	2017 £m		2016 £m		Change %		2016 £m		Change %	
	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit
Asia	3,805	2,368	3,599	2,030	6	17	3,773	2,123	1	12
US	1,662	906	1,561	790	6	15	1,641	830	1	9
UK and Europe	1,491	342	1,160	268	29	28	1,160	268	29	28
Total Group	6,958	3,616	6,320	3,088	10	17	6,574	3,221	6	12

New business performance
£m (% vs 2016)



Split of APE new business sales
£6,958m, +6% (+10% AER)
- Asia £3,805m, +1% (+6% AER)
- US £1,662m, +1% (+6% AER)
- UK and Europe £1,491m, +29%

Split of new business profit
£3,616m, +12% (+17% AER)
- Asia £2,368m, +12% (+17% AER)
- US £906m, +9% (+15% AER)
- UK and Europe £342m, +28%

Life insurance new business profit was up 12 per cent (17 per cent on an actual exchange rate basis) to £3,616 million, and **Life insurance new business APE sales** increased by 6 per cent (10 per cent on an actual exchange rate basis) to £6,958 million.

In **Asia**, new business profit was 12 per cent higher at £2,368 million (17 per cent on an actual exchange rate basis), primarily reflecting the beneficial impact of our strategic emphasis on increasing sales from health and protection business and pricing actions.

Our focus on quality is undiminished with regular premium contracts accounting for 94 per cent of APE sales and supporting a 26 per cent increase in health and protection new business profit. This favourable mix provides a high level of recurring income and an earnings profile that is significantly less correlated to investment markets.

In Hong Kong new business profit has increased by 8 per cent as we continue to focus on driving growth in health and protection business. This targeted shift to higher margin, but lower case size protection business, aligned with the de-emphasis of broker sales and the expected moderation in the level of sales from Mainland China has, as we reported previously, resulted in a 14 per cent reduction in Hong Kong APE sales.

Outside Hong Kong, new business profit increased by 20 per cent, in line with APE sales which were up 17 per cent. Our performance remains broad-based, with double digit growth in new business profit across both agency and bancassurance channels. In China, new business profit more than doubled, driven by higher sales and a significant uplift in regular premium health and protection business from our increased scale and productivity in the agency channel, together with a positive contribution from our bancassurance partners. In Singapore, new business profit increased by 22 per cent supported by APE sales growth of 21 per cent, reflecting growth across both agency and bancassurance channels. Indonesia's APE sales grew 2 per cent while new business profit declined 5 per cent due to product mix.

In the **US**, new business profit increased by 9 per cent to £906 million (up 15 per cent on an actual exchange rate basis) reflecting a modest increase in APE sales, up 1 per cent (6 per cent on an actual exchange rate basis) and the positive impact on future profit from a reduction in corporate income tax rates. Uncertainty regarding the application and implementation of the US Department of Labor Fiduciary Duty Rule has led to continued pressure on industry sales in 2017 which were down 11 per cent over the first nine months of the year. Despite this, Jackson's variable annuity sales increased by 1 per cent, with the economics on new business in variable annuities remaining extremely attractive, with high internal rates of return and short payback periods. Net inflows into Jackson's separate account asset balances, which drive fee-based earnings on variable annuity business, remained positive at £3.5 billion. More favourable market conditions relating to the institutional product market also provided Jackson with the opportunity to write APE sales of £232 million (2016: £193 million).

In our **UK life business**, our strategy of extending customer access to PruFund's with-profits investment option via additional product wrappers continues to drive growth in new business profit, which increased to £342 million, up 28 per cent. APE sales increased 29 per cent to £1,491 million. We have seen notable success with the build out of PruFund, which has contributed significantly towards an APE sales increase in individual pensions (up 110 per cent), income drawdown (up 35 per cent) and ISAs (up 7 per cent). Reflecting this performance, total PruFund assets under management of £35.9 billion as at 31 December 2017 were 46 per cent higher than at the start of the year.

Free surplus generation[2,3]

	Actual exchange rate			Constant exchange rate	
	2017 £m	2016 £m	Change %	2016 £m	Change %
Free surplus generation					
Asia	1,562	1,335	17	1,405	11
US	1,582	1,863	(15)	1,957	(19)
UK and Europe	1,486	1,287	15	1,287	15
Underlying free surplus generated from in-force life business and asset management before restructuring costs	4,630	4,485	3	4,649	–
Restructuring costs	(77)	(16)	(381)	(16)	(381)
Underlying free surplus generated from in-force life business and asset management	4,553	4,469	2	4,633	(2)
Investment in new business	(913)	(903)	(1)	(942)	3
Underlying free surplus generated	3,640	3,566	2	3,691	(1)
Market related movements, timing differences and other non-operating movements	(1,012)	(432)			
Profit (loss) attaching to disposal of businesses	172	(86)			
Net cash remitted by business units	(1,788)	(1,718)			
Total movement in free surplus	1,012	1,330			
Free surplus at end of year	7,578	6,566			

Free surplus generation is the financial metric we use to measure the internal cash generation of our business operations and is based on the capital regimes which apply locally in the various jurisdictions in which our life businesses operate. For life insurance operations it represents amounts maturing from the in-force business during the year, net of amounts reinvested in writing new business. For asset management it equates to post-tax IFRS operating profit for the period.

We drive free surplus generation by targeting markets and products that have low capital strain, high-return and fast payback profiles and by delivering both good service and value to improve customer retention. Our ability to generate both growth and cash is a distinctive feature of Prudential.

In 2017, underlying free surplus generation from our life insurance and asset management business decreased by 1 per cent to £3,640 million (increased 2 per cent on an actual exchange rate basis), reflecting increased contributions from our Asia and UK businesses, a non-recurrence of a one-off prior year gain from our US business, and higher restructuring costs. In Asia, growth in the in-force life portfolio, combined with post-tax asset management profit from Eastspring, contributed to free surplus generation of £1,562 million, up 11 per cent. In the US, in-force free surplus generation decreased by 19 per cent reflecting the non-recurrence of a £247 million benefit from contingent financing actions taken in 2016, together with lower favourable experience variances. In the UK, in-force free surplus generation increased by 15 per cent to £1,486 million, attributable to growth in asset management earnings, the adoption of the CMI 2015 assumption basis and portfolio and capital management actions including longevity reinsurance to improve the solvency position of our UK life business of £400 million (2016: £351 million). The result includes an increase in the provision for the costs of the UK review of past non-advised annuity sales practices and related potential redress, which has a post-tax impact of £187 million in 2017 (2016: £145 million).

Although new business profit increased by 12 per cent, the amount of free surplus invested in writing new life business in the period was lower at £913 million (2016: £942 million) reflecting a greater proportion of sales in Asia and the UK where strain is lower, and a higher proportion of variable annuity premium being allocated to the separate account in the US.

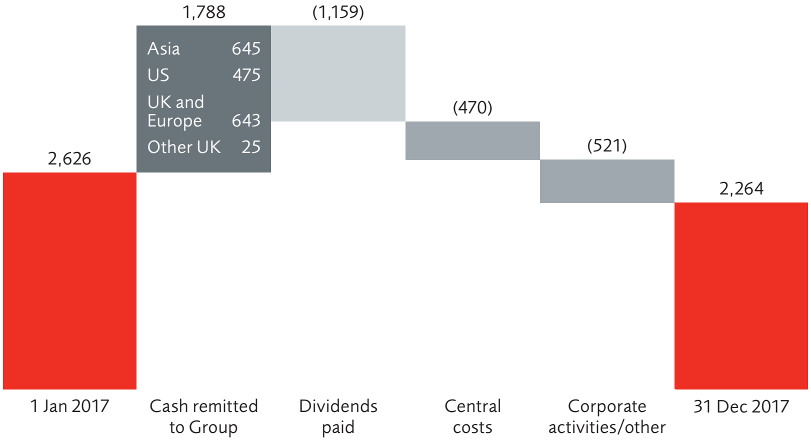
After funding cash remittances from the business units to the Group, recognition of the profit attaching to the disposal of businesses, and other movements, which includes adverse currency effects and the impact of US tax reform, the closing value of free surplus in our life and asset management operations was £7.6 billion at 31 December 2017.

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

Business unit remittance[2,16]

	Actual exchange rate	
	2017 £m	**2016** £m
Net cash remitted by business units:		
Asia	645	516
US	475	420
UK and Europe	643	590
Other UK (including Prudential Capital)	25	192
Net cash remitted by business units	1,788	1,718
Holding company cash at 31 December	2,264	2,626

Movement in central cash[2,16]
£m



● 2016 second interim dividend and 2017 first interim dividend

Cash remitted to the corporate centre in 2017 amounted to £1,788 million, driven by higher remittances from Asia. For the first time, our Asia business unit is the largest contributor[17] to cash in the Group, demonstrating the quality and scale of its growth. Jackson made sizeable remittances of £475 million. The remittance from M&G Prudential of £643 million was 9 per cent higher than the combined remittance in 2016. Prudential Capital contributed a further £25 million.

Cash remitted to the Group in 2017 was used to meet central costs of £470 million (2016: £416 million) and pay the 2016 second interim and 2017 first interim dividends respectively. These movements and other corporate cash flows, including a net reduction in core structural borrowings and the impact of currency movements, led to holding company cash decreasing from £2,626 million to £2,264 million over 2017.

Post-tax profit – EEV[2]

	Actual exchange rate			Constant exchange rate	
	2017 £m	2016 £m	Change %	2016 £m	Change %
Post-tax operating profit based on longer-term investment returns					
Asia operations					
Long-term business	3,705	3,074	21	3,220	15
Asset management	155	125	24	132	17
Total	3,860	3,199	21	3,352	15
US operations					
Long-term business	2,143	1,971	9	2,071	3
Asset management	7	(3)	333	(4)	275
Total	2,150	1,968	9	2,067	4
UK and Europe operations					
Long-term business	1,015	643	58	643	58
General insurance commission	13	23	(43)	23	(43)
Total insurance operations	1,028	666	54	666	54
Asset management	403	341	18	341	18
Total	1,431	1,007	42	1,007	42
Other income and expenditure[18]	(746)	(682)	(9)	(688)	(8)
Post-tax operating profit based on longer-term investment returns before restructuring costs and interest received from tax settlement	6,695	5,492	22	5,738	17
Restructuring costs[18]	(97)	(32)	(203)	(32)	(203)
Interest received from tax settlement	–	37	n/a	37	n/a
Post-tax operating profit based on longer-term investment returns	6,598	5,497	20	5,743	15
Non-operating items:					
Short-term fluctuations on investment returns	2,111	(507)	516	(567)	472
Effect of changes in economic assumptions	(102)	(60)	(70)	(54)	(89)
Mark to market value movements on core structural borrowings	(326)	(4)	(8,050)	(4)	(8,050)
Impact of US tax reform	390	–	n/a	–	n/a
Profit (loss) attaching to disposal of businesses	80	(410)	n/a	(445)	n/a
Post-tax profit for the year	8,751	4,516	94	4,673	87

Earnings per share

	Actual exchange rate			Constant exchange rate	
	2017 pence	2016 pence	Change %	2016 pence	Change %
Basic earnings per share based on post-tax operating profit	257.0	214.7	20	224.3	15
Basic earnings per share based on post-tax total profit	340.9	176.4	93	182.5	87

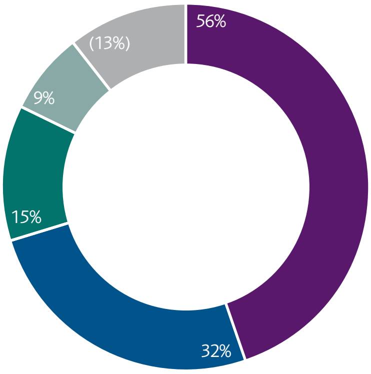
EEV operating profit
On an EEV basis, Group post-tax operating profit based on longer-term investment return increased by 15 per cent (up 20 per cent on an actual exchange rate basis) to £6,598 million in 2017.

EEV operating profit includes new business profit from the Group's life business, which increased by 12 per cent (up 17 per cent on an actual exchange rate basis) to £3,616 million. It also includes in-force life business profit of £3,247 million, which was 20 per cent higher than prior year (up 25 per cent on an actual exchange rate basis), primarily reflecting the growth in our in-force business. This is most evident in the profit from the unwind of the in-force business, which was 10 per cent higher at £2,166 million (2016: £1,962 million). Experience and assumption changes were positive at £1,081 million (2016: £751 million), reflecting our ongoing focus on managing the in-force book for value.

In **Asia**, EEV life operating profit was up 15 per cent to £3,705 million, reflecting growth in new business profit of 12 per cent at £2,368 million. In-force profit was 22 per cent higher at £1,337 million reflecting the increased value of in-force business and positive assumption changes and experience as the business continues to grow with discipline.

Jackson's EEV life operating profit was up 3 per cent to £2,143 million, reflecting a 9 per cent increase in new business profit to £906 million and a stable contribution from in-force profit of £1,237 million, which included favourable operating assumption changes and experience variances of £543 million (2016: £628 million), related largely to persistency and mortality effects. The increase in our US EEV new business profit reflects the positive impact on future profits from lower tax rates.

EEV operating profit by business[2]
£m (% vs 2016)



£6,598m
+15% (+20% AER)

- Asia life £3,705m, +15% (+21% AER)
- US life £2,143m, +3% (+9% AER)
- UK and Europe life £1,015m, +58%
- Asset management and general insurance £578m, +17% (+19% AER)
- Other[18] £(843)m, -23% (-25% AER)

In the **UK and Europe**, EEV life operating profit increased by 58 per cent to £1,015 million (2016: £643 million). The increase was driven by a 28 per cent increase in new business profit, and higher in-force profit including a £195 million benefit from revisions to longevity assumptions following adoption of updated actuarial mortality projections under CMI 2015[19]. Profits arising from actions undertaken to improve solvency were more than offset by an increase in the provision related to the potential costs and related potential redress of reviewing internally vesting annuities sold without advice after 1 July 2008.

Capital position, financing and liquidity

Capital position

Analysis of movement in Group shareholder Solvency II surplus[20]

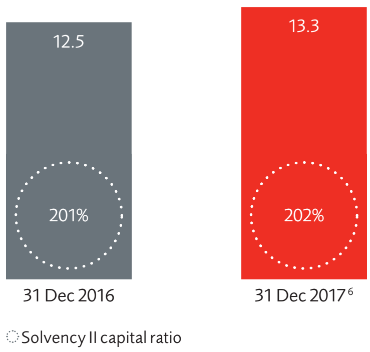
	2017 £bn	**2016** £bn
Solvency II surplus at 1 January	12.5	9.7
Operating experience	3.6	2.7
Non-operating experience (including market movements)*	(0.6)	(1.1)
Other capital movements		
Subordinated debt (redemption)/issuance	(0.2)	1.2
Foreign currency translation impacts	(0.7)	1.6
Dividends paid	(1.2)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

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

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in an increase in the Group's shareholders' Solvency II capital surplus which is estimated at £13.3 billion[6,7], at 31 December 2017 (equivalent to a solvency ratio of 202 per cent), compared with £12.5 billion (201 per cent) at 31 December 2016. In 2017 we generated £3.6 billion of operating capital. This was offset by dividends to shareholders, net repayment of subordinated debt, adverse foreign currency effects and the £0.6 billion reduction in statutory deferred tax assets following US tax reform.

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

Solvency II surplus[20] £bn



Local statutory capital

All of our subsidiaries continue to hold appropriate capital levels on a local regulatory basis. In the UK, at 31 December 2017 The Prudential Assurance Company Limited and its subsidiaries[21] had an estimated Solvency II shareholder surplus[22] of £6.1 billion (equivalent to a cover ratio of 178 per cent) and a with-profits surplus[23] of £4.8 billion (equivalent to a cover ratio of 201 per cent). In the US, following the enactment in December 2017 of a comprehensive reform package, a £628 million reduction in the level of the statutory net admitted deferred tax asset more than offset operational capital formation, resulting in a risk based capital ratio of 409 per cent (2016: 485 per cent).

Debt portfolio

The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders' exposure to credit is concentrated in the UK annuity portfolio and the US general account, mainly attributable to Jackson's fixed annuity portfolio. The credit exposure is well diversified and 98 per cent of our UK portfolio and 97 per cent of our US portfolio are investment grade[29]. During 2017, default losses were minimal and reported impairments across the UK and US portfolios were £2 million (2016: £35 million).

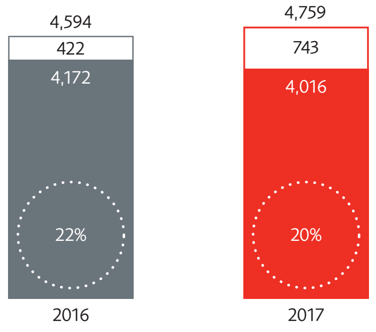
Financing and liquidity

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

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

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

Net core structural borrowings
£m (EEV basis)

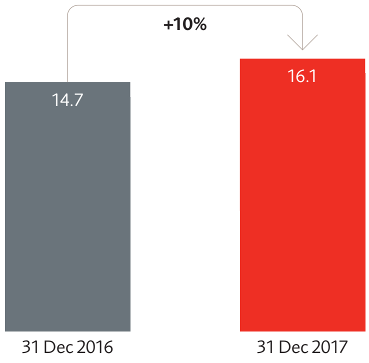


* Net core structural borrowings as proportion of IFRS shareholders' funds plus net debt, as set out in note II(d) of the Additional unaudited financial information.

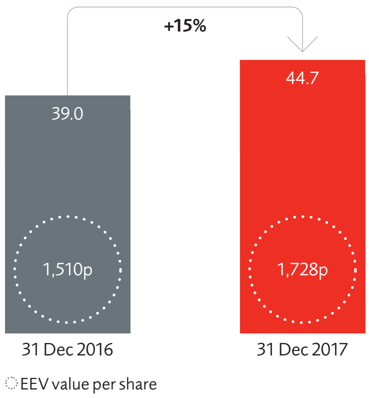
Shareholders' funds

	IFRS		EEV	
	2017 £m	**2016** £m	**2017** £m	**2016** £m
Profit after tax for the year[24]	2,389	1,921	8,750	4,516
Exchange movements, net of related tax	(409)	1,161	(2,045)	4,211
Cumulative exchange gain of Korea life business recycled to profit and loss account	(61)	–	–	–
Unrealised gains and losses on Jackson fixed income securities classified as available for sale[25]	486	31	–	–
Dividends	(1,159)	(1,267)	(1,159)	(1,267)
Market to market value movements on Jackson assets backing surplus and required capital	–	–	40	(11)
Other	175	(135)	144	(367)
Net increase in shareholders' funds	1,421	1,711	5,730	7,082
Shareholders' funds at 1 January	14,666	12,955	38,968	31,886
Shareholders' funds at 31 December	16,087	14,666	44,698	38,968
Shareholders' value per share[26]	622p	568p	1,728p	1,510p
Return on shareholders' funds[27]	25%	26%	17%	17%

IFRS shareholders' funds
£bn



EEV shareholders' funds
£bn



Group IFRS shareholders' funds at 31 December 2017 increased by 10 per cent to £16.1 billion (31 December 2016: £14.7 billion on an actual exchange rate basis), driven by the strength of the operating result, offset by dividend payments of £1,159 million. During the period, UK sterling has strengthened relative to the US dollar and various Asian currencies. With approximately 50 per cent of the Group's IFRS net assets (71 per cent of the Group's EEV net assets) denominated in non-sterling currencies, this generated a negative exchange rate movement on the net assets in the period. In addition, the moderate decline in US long-term interest rates between the start and the end of the reporting period produced unrealised gains on fixed income securities held by Jackson accounted through other comprehensive income.

The Group's EEV basis shareholders' funds also increased by 15 per cent to £44.7 billion (31 December 2016: £39.0 billion on an actual exchange rate basis), On a per share basis the Group's embedded value at 31 December 2017 equated to 1,728 pence, up from 1,510 pence at 31 December 2016.

Corporate transactions

Intention to demerge the Group's UK businesses and sale of £12.0 billion[30] UK annuity portfolio

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

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

M&G Prudential agreed in March 2018 to the sale of £12.0 billion[30] of its shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured £12.0 billion[30] of liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The capital benefit of this transaction will be retained within the Group to support the demerger process.

The IFRS liabilities relating to M&G Prudential's total UK shareholder annuity portfolio as at 31 December 2017 were £32.6 billion. The UK annuity business being sold contributed around £140 million towards UK life insurance core[5] IFRS operating profit before tax of £597 million in 2017. Total M&G Prudential IFRS operating profit before tax was £1,378 million in 2017.

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

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

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

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

Chief Financial Officer's report on the 2017 financial performance – Mark FitzPatrick continued

Pro forma estimated Group shareholder Solvency II capital position

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

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

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

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

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

* The pro forma estimate assumes that the partial sale of the UK annuity portfolio and the transfer of Prudential plc's Hong Kong subsidiaries to Asia had both been completed as at 31 December 2017. In relation to the sale of the UK annuity portfolio, this estimate includes a £1.3 billion reduction in the Solvency Capital Requirement (SCR) and a £0.2 billion decrease in Own Funds, resulting in an increase in capital surplus of £1.1 billion, of which £0.6 billion is expected to be recognised in the UK capital position as at 30 June 2018 under the reinsurance agreement. In relation to the Hong Kong transfer, the impact on the SCR allows for the release of the Hong Kong business standalone SCR of £2.0 billion, partially offset by the removal of diversification benefits between UK and Hong Kong of £1.1 billion.

Entrance into Nigeria

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

Disposal of Korea life

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

Disposal of broker-dealer network in the US

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

Dividend

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

The Group's dividend policy remains unchanged. The Board will maintain focus on delivering a growing ordinary dividend. In line with this policy, Prudential aims to grow the ordinary dividend by 5 per cent per annum. The potential for additional distributions will continue to be determined after taking into account the Group's financial flexibility across a broad range of financial metrics and an assessment of opportunities to generate attractive returns by investing in specific areas of the business[28].

Mark FitzPatrick
Chief Financial Officer

Notes

1 Increase stated on a constant exchange rate basis.
2 The 2016 comparative results have been re-presented from those published previously, following reassessment of the Group's operating segments as described in note B1.3 of the IFRS financial statements.
3 Underlying free surplus generated comprises underlying free surplus generated from the Group's long-term business (net of investment in new business) and that generated from asset management operations. Further information is set out in note 11 of the EEV basis results. Free surplus represents 'underlying free surplus' based on operating movements and excludes market movements, foreign exchange, capital movements, shareholders' other income and expenditure and restructuring and Solvency II implementation costs arising centrally.
4 Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
5 Core refers to the underlying profit of the UK and Europe insurance business excluding the effect of, for example, management actions to improve solvency and material assumption changes. Details of these are set out in note I(d) of the Additional unaudited financial information.
6 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.
7 Before allowing for second interim ordinary dividend.
8 Refer to note B1.1 in IFRS financial statements for the breakdown of other income and expenditure and other non-operating items.
9 Gross earned premiums for contracts in second and subsequent years, comprising Asia segment IFRS gross earned premium of £15.7 billion less gross earned premiums relating to new regular and single premiums of £5.7 billion, plus renewal premiums from joint ventures of £1.6 billion, and excluding any amounts relating to the sold Korea life business.
10 Includes Group's proportionate share of the liabilities and associated flows of the insurance joint ventures and associates in Asia.
11 Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.
12 Includes Unallocated surplus of with-profits business.
13 Includes Group's proportionate share in PPM South Africa and the Asia asset management joint ventures.
14 For our asset management business the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(b) of the Additional unaudited financial information.
15 Net inflows exclude Asia Money Market Fund (MMF) inflows of £1,495 million (2016: net inflows £403 million). External funds under management exclude Asia MMF balances of £9,317 million (2016: £7,714 million).
16 Net cash remitted by business units are included in the Holding company cash flow, which is disclosed in detail in note II(a) of the Additional unaudited financial information.
17 Based on the 2017 operating segments.
18 Refer to the EEV basis supplementary information – Post-tax operating profit based on longer-term investment returns and Post-tax summarised consolidated income statement, for further detail on other income and restructuring costs.
19 Continuous Mortality Investigation 2015 mortality improvements model.
20 The methodology and assumptions used in calculating the Solvency II capital results are set out in note II(f) of the Additional unaudited financial information.
21 The insurance subsidiaries of The Prudential Assurance Company Limited are Prudential General Insurance Hong Kong Limited, Prudential Hong Kong Limited, Prudential International Assurance plc and Prudential Pensions Limited.
22 The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.
23 The estimated solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date. An application to recalculate the transitional measures as at 31 December 2017 has been approved by the Prudential Regulation Authority.
24 Excluding profit for the year attributable to non-controlling interests.
25 Net of related charges to deferred acquisition costs and tax.
26 Closing IFRS shareholders' funds divided by issued shares, as set out in note II(e) of the Additional unaudited financial information. Closing EEV shareholders' funds divided by issued shares, as set out in note II(n) of the Additional unaudited financial information.
27 Operating profit after tax and non-controlling interests as percentage of opening shareholders' funds, as set out in notes II(c) and II(m) of the Additional unaudited financial information.
28 Refer to note 11 on the parent company financial statements for further detail on the distributable profits of Prudential plc.
29 Based on hierarchy of Standard & Poor's, Moody's and Fitch, where available and if unavailable, internal ratings have been used.
30 Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.