

Notes on the EEV basis supplementary information

1. Basis of preparation

The EEV basis results have been prepared in accordance with the EEV principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005. Where appropriate the EEV basis results include the effects of adoption of International Financial Reporting Standards (IFRS).

The EEV results for the Group include the results for the covered business on the EEV basis. These results are then combined with the IFRS basis results of the Group's other operations.

With two exceptions, covered business comprises the Group's long-term business operations. The definition of long-term business operations is consistent with previous practice under modified statutory basis (MSB) and achieved profits basis reporting and comprises those contracts falling under the definition of long-term insurance business for regulatory purposes together with, for US operations, contracts that are in substance the same as guaranteed investment contracts (GICs) but do not fall within the technical definition. Under the EEV principles, the results for covered business now incorporate the projected margins of attaching internal fund management.

The exceptions are for the closed Scottish Amicable Insurance Fund (SAIF) and in respect of the Group's defined benefit pension schemes. SAIF is closed to new business and the assets and liabilities of the fund are wholly attributable to the policyholders of the fund. As regards the Group's defined benefit pension schemes, the deficits attaching to the Prudential Staff Pension Scheme (PSPS) and Scottish Amicable scheme are excluded. These deficits are partially attributable to the Prudential Assurance Company (PAC) with-profits fund and shareholder-backed long-term business. Further details are explained in note 2f.

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

Previously, the Group has reported supplementary information on the achieved profits basis for its interim and full year financial reporting. The adoption of the EEV basis reporting in place of achieved profits basis reporting reflects developments through the CFO Forum to achieve a better level of consistency and an improved embedded value methodology, and is applied by the major European insurance companies in their financial reporting.

2. Methodology

a) Embedded value

Overview

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

- Present value of future shareholder cash flows from in-force covered business (value of in-force business), less a deduction for the cost of locked-in (encumbered) capital;
- locked-in (encumbered) capital; and
- shareholders' net worth in excess of encumbered capital.

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

Notwithstanding the basis of presentation of results (as explained in notes 4 and 6) no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or the profit before tax.

Value of in-force business

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

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same as that calculated under the IFRS basis and, prior to IFRS adoption, the MSB under UK Generally Accepted Accounting Principles (GAAP). However, since the embedded value basis reflects discounted future cash flows under this methodology the profit emergence is advanced, thus more closely aligning the timing of the recognition of profits with the efforts and risks of current management actions, particularly with regard to business sold during the year.

Cost of capital

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

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

Where the capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its release over time and no further adjustment is necessary in respect of solvency capital. However, where business is funded directly by shareholders, the capital requires adjustment to reflect the cost of that capital to shareholders.

2. Methodology continued

Financial options and guarantees

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

UK insurance operations

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

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses: annual and final. Annual bonuses are declared once a year, and once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits sub-fund held a provision on the Pillar 1 Peak 2 basis of £52 million (2004: £49 million) at 31 December 2005 to honour guarantees on a small amount of guaranteed annuity products.

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

The Group's main exposure to guaranteed annuities in the UK is through SAIF and a provision on the Pillar 1 Peak 2 basis of £619 million (2004: £648 million) was held in SAIF at 31 December 2005 to honour the guarantees.

Jackson National Life

The principal options and guarantees valued under EEV for Jackson National Life (JNL) are associated with the fixed annuity and variable annuity lines of business.

Fixed annuities provide that at JNL's discretion it may reset the interest rate credited to policyholders' accounts, subject to a guaranteed minimum. The guaranteed minimum return varies from 1.5 per cent to 5.5 per cent (2004: 1.5 per cent to 5.5 per cent), depending on the particular product, jurisdiction where issued, and date of issue. At 31 December 2005, 73 per cent (2004: 73 per cent) of the fund relates to policies with guarantees of 3 per cent or less. The average guarantee rate is 3.3 per cent (2004: 3.3 per cent).

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

Variable annuity contracts may contain guarantees of certain minimum payments in the event of death, withdrawal or annuitisation. These guarantees may be related to (a) the amount of total deposits made to the contract adjusted for any partial withdrawals, (b) the total deposits made to the contract adjusted for any partial withdrawals, plus a minimum annual return, or (c) the highest contract value on a specified anniversary date adjusted for any withdrawals following the contract anniversary.

These guarantees generally protect the policyholder's value in the event of poor equity market performance.

JNL also issues fixed index annuities that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns would be of a similar nature as those described above for fixed annuities. In the case of the potential equity participation, JNL hedges this risk by purchasing futures and options on the relevant index.

Asian operations

Subject to local market circumstances and regulatory requirements, the guarantee features described above in respect of UK business broadly apply to similar types of participating contracts written in the PAC 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 insurer is contractually obliged to provide guarantees on all benefits. The most significant book of non-participating business in the Group's Asian operations is Taiwan's whole of life contracts. For these contracts there are floor levels of policyholder benefits that accrue at rates set at inception which are set by reference to minimum returns established by local regulation at the time of inception. These rates do not vary subsequently with market conditions. Under these contracts the cost of premiums are also fixed at inception based on a number of assumptions at that time, including long-term interest rates, mortality assumptions and expenses. The guaranteed maturity and surrender values reflect the pricing basis.

Time value

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

Where appropriate, a full stochastic valuation has been undertaken to determine the value of the in-force business including the cost of capital. A deterministic valuation of the in-force business is also derived using consistent assumptions and the time value of the financial options and guarantees is derived as the difference between the two.

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations. Assumptions specific to the stochastic calculations such as equity volatility and credit losses reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of long-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with allowance for correlation between the various asset classes. Details of the key characteristics of each model are given in note 3.

Notes on the EEV basis supplementary information *continued*

2. Methodology *continued*

b) Level of encumbered capital

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

- UK: economic capital requirements for annuity business are fully met by Pillar I requirements being 4 per cent of mathematical reserves (as used for achieved profits reporting), which are also sufficient to meet Pillar II requirements;
- US: level of capital that has previously been locked in for achieved profits reporting, namely 235 per cent of the risk-based capital required by the National Association of Insurance Commissioners at the Company Action Level (CAL), is sufficient to meet the economic capital requirement;
- Asia: economic capital target is substantially higher than local statutory requirements in total. Economic capital requirements vary by territory, but in aggregate, the encumbered capital is equivalent to the amount required under the Financial Conglomerates Directive (FCD).

The table below summarises the levels of encumbered capital as a percentage of the relevant statutory requirement:

	Capital as a percentage of relevant statutory requirement
UK business (excluding annuities)	100% of EU minimum
UK annuity business	100% of EU minimum
Jackson National Life	235% of CAL
Asian operations	100% of FCD

c) Risk discount rates

Overview

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

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

For Prudential's UK annuity business, which is well matched, the predominant risks are credit risk and longevity risk. For this line of business the achieved profits methodology for embedded values has been carried over and the risk discount rate has been derived by comparison to a market consistent valuation.

Allowance for risk

The risk allowance in the risk discount rate is determined as follows:

Market risk

Under Capital Asset Pricing Methodology (CAPM) the discount rate is determined as:

Discount rate = risk-free rate + (beta x equity risk premium)

Under CAPM, the beta of a portfolio or product measures its relative market risk.

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

CAPM does not include any allowance for non-market risks since these are assumed to be fully diversifiable. For EEV purposes, however, a risk margin is added for non-diversifiable non-market risks and to cover Group level risks.

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

2. Methodology continued

Diversifiable non-market risks

No allowance is required for non-market risks where these are assumed to be fully diversifiable. The majority of non-market risks are considered to be diversifiable.

Non-diversifiable, non-market risks

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

A constant margin of 50 basis points has been added to the risk margin derived for market risk to cover the non-diversifiable non-market risks associated with the business.

d) Management actions

In deriving the time value of financial options and guarantees, management actions in response to emerging investment and fund solvency conditions have been modelled. Management actions encompass, but are not confined to, the following areas:

- Investment allocation decisions;
- levels of reversionary bonuses and credited rates; and
- total claim values.

Bonus rates are projected from current levels and varied in accordance with assumed management actions applying in the emerging investment and fund solvency conditions.

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

e) With-profits business and the treatment of the estate

For the PAC with-profits sub-fund, the shareholders' interest in the estate is derived by increasing terminal bonus rates so as to exhaust the estate over the lifetime of the in-force with-profits business. In those few extreme scenarios where the total assets of the life fund are insufficient to meet policyholder claims in full, the excess cost is fully attributed to shareholders.

f) Pension costs

The Group operates three defined benefit schemes in the UK. The principal scheme is the Prudential Staff Pension Scheme (PSPS). The other two much smaller schemes are the Scottish Amicable and M&G schemes. There is also a small scheme in Taiwan.

Under IFRS the deficits attaching to these schemes are accounted for in accordance with the provisions of IAS 19. The deficits represent the difference between the market value of the schemes' assets and the discounted value of projected future benefit payments to retired members and deferred pensioners and, to the extent of service to date, current employed members.

For PSPS the deficit is allocated between the PAC with-profits sub-fund and shareholder-backed operations by reference to the activities of the members of the scheme during their period of service. For the 2004 year end the deficit was allocated in the ratio 80/20. For the 2005 year end, following further detailed consideration of the sourcing of previous contributions by Group companies and funds, this ratio has been altered to 70/30 for the allocation of the deficit between the with-profits sub-fund and shareholder-backed operations. Additional details on the effect of the movement on the deficits of the Group's defined benefit pension schemes is set out in note 9.

Under the EEV basis the IAS 19 basis deficit is initially allocated in the same manner. The shareholders' 10 per cent interest in the PAC with-profits sub-fund estate is determined after deduction of the portion of the IAS 19 basis deficits attributable to the fund. Adjustments under EEV in respect of accounting for deficits on deferred benefit schemes are reflected as part of other operations, as shown in note 13.

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

g) Debt capital

Core structural debt liabilities are carried at market value.

Notes on the EEV basis supplementary information *continued*

3. Assumptions

a) Best estimate assumptions

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

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

b) Principal economic assumptions

Deterministic

In most countries, the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on fixed interest securities. This 'active' basis of assumption setting has been applied in preparing the results of all the Group's UK and US long-term business operations. For the Group's Asian operations, the active basis is appropriate for business written in Japan, Korea and US dollar denominated business written in Hong Kong.

An exception to this general rule is that for countries where long-term fixed interest markets are underdeveloped, investment return assumptions and risk discount rates are based on an assessment of longer-term economic conditions. Except for the countries listed above, this basis is appropriate for the Group's Asian operations.

Expected returns on equity and property asset classes are derived by adding a risk premium, also based on the long-term view of Prudential's economists in respect of each territory, to the risk-free rate. In the UK the equity risk premium is 4.0 per cent (2004: 3.0 per cent) above risk-free rates. The equity risk premium in the US is also 4.0 per cent (2004: 3.0 per cent). In Asia, equity risk premiums range from 3.0 per cent to 5.75 per cent. Assumptions for other asset classes, such as corporate bond spreads, are set consistently as best estimate assumptions.

The investment return assumptions as derived above are applied to the actual assets held at the valuation date to derive the overall fund-earned rate.

The table below summarises the principal financial assumptions:

	31 Dec 2005 %	31 Dec 2004 %
UK insurance operations		
Risk discount rate:		
New business	7.55	7.1
In force	7.7	7.1
Pre-tax expected long-term nominal rates of investment return:		
UK equities	8.1	7.6
Overseas equities	8.1 to 8.75	7.3 to 8.3
Property	6.4	6.3
Gilts	4.1	4.6
Corporate bonds	4.9	5.5
Expected long-term rate of inflation	2.9	2.9
Post-tax expected long-term nominal rate of return:		
Pension business (where no tax applies)	7.1	6.8
Life business	6.3	5.9
US operations (Jackson National Life)		
Risk discount rate:		
New business	6.9	6.1
In force	6.1	5.8
Expected long-term spread between earned rate and rate credited to policyholders for single premium deferred annuity business	1.75	1.75
US 10-year treasury bond rate at end of period	4.4	4.3
Pre-tax expected long-term nominal rate of return for US equities	8.4	7.3
Expected long-term rate of inflation	2.4	2.6

3. Assumptions continued

Asian operations

	China 31 Dec 2005 %	Hong Kong (note iii) 31 Dec 2005 %	India 31 Dec 2005 %	Indonesia 31 Dec 2005 %	Japan 31 Dec 2005 %	Korea 31 Dec 2005 %	China 31 Dec 2004 %	Hong Kong (note iii) 31 Dec 2004 %	India 31 Dec 2004 %	Indonesia 31 Dec 2004 %	Japan 31 Dec 2004 %	Korea 31 Dec 2004 %
Risk discount rate:												
New business	12.0	5.9	16.5	17.5	5.0	10.3	10.0	4.7	16.0	18.75	5.0	7.1
In force	12.0	6.15	16.5	17.5	5.0	10.3	10.0	5.0	16.0	18.75	5.0	7.1
Expected long-term rate of inflation	4.0	2.25	5.5	6.5	0.0	2.75	3.0	2.25	5.25	7.75	0.0	2.75
Government bond yield	9.0	4.8	10.5	11.5	1.8	5.8	7.25	4.9	10.25	13.0	1.9	3.9

	Malaysia 31 Dec 2005 %	Philippines 31 Dec 2005 %	Singapore 31 Dec 2005 %	Taiwan (note ii) 31 Dec 2005 %	Thailand 31 Dec 2005 %	Vietnam 31 Dec 2005 %	Malaysia 31 Dec 2004 %	Philippines 31 Dec 2004 %	Singapore 31 Dec 2004 %	Taiwan (note ii) 31 Dec 2004 %	Thailand 31 Dec 2004 %	Vietnam 31 Dec 2004 %
Risk discount rate:												
New business	9.4	16.5	6.7	9.0	13.75	16.5	9.0	16.25	6.3	7.1	13.5	15.5
In force	9.0	16.5	6.8	9.4	13.75	16.5	8.7	16.25	6.4	8.2	13.5	15.5
Expected long-term rate of inflation	3.0	5.5	1.75	2.25	3.75	5.5	3.0	5.25	2.25	2.25	3.75	4.5
Government bond yield	7.5	10.5	4.5	5.5	7.75	10.5	7.0	10.5	5.0	5.5	7.75	9.75

	Asia total 31 Dec 2005 %	Asia total 31 Dec 2004 %
Weighted risk discount rate (note i)		
New business	9.8	8.0
In force	8.4	7.9

Notes

(i) The weighted discount rates for the Asian operations shown above have been determined by weighting each country's discount rates by reference to the EEV basis operating result for new business and the closing value of in-force business.

(ii) For traditional business in Taiwan, the economic scenarios used to calculate 2005 EEV basis results reflect the assumption of a phased progression of the bond yields from the current rates to the long-term expected rates. The projections assume that, in the average scenario, the current bond yields of around 2 per cent trend towards 5.5 per cent at 31 December 2012. Allowance is made for the mix of assets in the fund, our future investment strategy and the market value depreciation of the bonds as a result of the assumed yield increases. This gives rise to an average assumed Fund Earned Rate that trends from 2.3 per cent to 5.4 per cent in 2013 and falls below 2.3 per cent for seven years due to the depreciation of bond values as yields rise. Thereafter, the Fund Earned Rate fluctuates around a target of 5.9 per cent. This compares to a grading of 3.4 per cent at 31 December 2004 to 5.9 per cent by 31 December 2012 for the 2004 results. Consistent with our EEV methodology, a constant discount rate has been applied to the projected cash flows.

(iii) Assumptions for US dollar denominated business which comprises the larger proportion of the in-force Hong Kong business.

(iv) Assumed equity yields

The most significant equity holdings in the Asian operations are in Hong Kong, Singapore and Malaysia. The mean equity return assumptions for those territories at 31 December 2005 (2004) were 8.6 per cent (7.3 per cent), 9.3 per cent (9.75 per cent) and 12.8 per cent (12.25 per cent). To obtain the mean, an average over all simulations of the accumulated return at the end of the projection period is calculated. The annual average return is then calculated by taking the root of the average accumulated return minus 1.

Stochastic

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations described above. Assumptions specific to the stochastic calculations such as the volatilities of asset returns reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of longer-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with allowance for correlation between the various asset classes.

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

UK insurance operations

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

Notes on the EEV basis supplementary information *continued*

3. Assumptions *continued*

The rates to which the model has been calibrated are set out below:

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

Standard deviations have been calculated by taking the annualised variance of the returns over all the simulations, taking the square root and averaging over all durations in the projection. For bonds the standard deviations relate to the yields on bonds of the average portfolio duration. For equity and property, they relate to the total return on these assets. The standard deviations applied are as follows:

	Standard deviation %
Government bond yield	2.0
Corporate bond yield	5.5
Equities:	
UK	18.0
Overseas	16.0
Property	15.0

Jackson National Life

- Interest rates are projected using a log-normal generator calibrated to actual market data;
- corporate bond returns are based on Treasury securities plus a spread that has been calibrated to current market conditions and varies by credit quality; and
- variable annuity equity and bond returns have been stochastically generated using a regime-switching log-normal model with parameters determined by reference to historical data. The volatility of equity fund returns ranges from 18.6 per cent to 28.1 per cent, depending on risk class, and the volatility of bond funds ranges from 1.4 per cent to 1.8 per cent.

Asian operations

The same asset return model, as used in the UK, appropriately calibrated, has been used for the Asian operations. The principal asset classes are government and corporate bonds. Equity holdings are much lower than in the UK whilst property is not held as an investment asset.

The stochastic cost of guarantees are only of significance for the Hong Kong, Singapore, Malaysia and Taiwan operations.

The mean stochastic returns are consistent with the mean deterministic returns for each country. The volatility of equity returns ranges from 18 per cent to 26 per cent, and the volatility of government bond returns ranges from 1.6 per cent to 8.9 per cent.

c) Demographic assumptions

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

d) Expense assumptions

Expense levels, including those of service companies that support the Group's long-term business operations, are based on internal expense analysis investigations and are appropriately allocated to acquisition of new business and renewal of in-force business. Exceptional expenses are identified separately and reported separately. No productivity gains have been assumed.

Asia development and Regional Head Office expenses are charged to EEV basis results as incurred. No adjustment is made to the embedded value of covered business as the amounts of expenditure that relate to operating expenses are not material. Similarly corporate expenditure for Group Head Office, to the extent not allocated to the PAC with-profits fund, is charged to the EEV basis result as incurred.

e) Inter-company arrangements

There are no inter-company arrangements such as reinsurance or loans associated with covered business for which adjustment has been required in preparing the EEV basis results.

f) Taxation and other legislation

Current taxation and other legislation has been assumed to continue unaltered except where changes have been announced and the relevant legislation passed.

g) Fund management and service companies

The value of future profits or losses from fund management and service companies that support the Group's covered businesses are included in the profits for new business and the in-force value of the Group's long-term business.

4. Accounting presentation

a) Analysis of profit before tax

To the extent applicable, presentation of the EEV profit for the year is consistent with the basis the Group applies for analysis of IFRS basis profits before shareholder taxes between operating and non-operating results. Operating results reflect the underlying results of the Group's continuing operations including longer-term investment returns. Operating results include the impact of routine changes of estimates and non-economic assumptions. Non-operating results include certain recurrent and exceptional items that primarily do not reflect the performance in the year of the Group's continuing operations.

b) Investment return

Profit before tax

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

In the case of JNL, market value movements on debt securities are initially recorded as movements in shareholder reserves, reflecting the available-for-sale categorisation under IFRS. Similarly the value movements on derivatives are recorded in the income statement. However, it is assumed that fixed income investments will normally be held until maturity. Therefore, unrealised gains and losses on these securities are not reflected in either the EEV or statutory basis results and, except on realisation or impairment of investments, only income received and the amortisation of the difference between cost and maturity values are recognised to the extent attributable to shareholders. This is consistent with the basis of valuation of future cash flows of in-force business, which inter alia, reflects spread basis earnings which are not directly affected by short-term value movements in fixed income securities. Similar principles apply to value movements on JNL's derivatives that are fair valued for IFRS reporting with value movements booked in the IFRS income statement.

Investment returns reflect those earned on a market basis over the period without smoothing, but after appropriate adjustments for movements in the additional shareholders' interest recognised on the EEV basis.

Operating profit

Investment returns, including investment gains, in respect of long-term insurance business are recognised in operating results at the expected long-term rate of return. For the purposes of calculating longer-term investment return to be included in operating results of UK operations, where equity holdings are a significant proportion of investment portfolios, values of assets at the beginning of the reporting period are adjusted to remove the effects of short-term market volatility.

For the purposes of determining the long-term returns for debt securities of shareholder-backed operations, a risk margin charge is included which reflects the expected long-term rate of default based on the credit quality of the portfolio. Interest-related realised gains and losses are amortised to the operating results over the maturity period of the sold bonds. For equity-related investments of JNL, a long-term rate of return is assumed, which reflects the aggregation of risk-free rates and equity risk premium.

c) Pension costs

Profit before tax

Movements on the shareholders' share of deficits of the Group's defined benefit pension schemes adjusted for contributions paid in the year are recorded within the income statement. Consistent with the basis of distribution of bonuses and the treatment of the estate described in notes 2d) and 2e), the shareholders' share incorporates 10 per cent of the proportion of the deficits attributable to the PAC with-profits sub-fund. The deficits are determined by applying the requirements of IAS 19.

Actuarial gains and losses

Actuarial gains and losses comprise:

- The difference between actual and expected return on the scheme assets;
- experience gains and losses on scheme liabilities; and
- the impact of altered economic and other assumptions on the discount value of scheme liabilities.

These items are recorded in the income statement but, consistent with the IFRS basis of presentation, are excluded from operating results.

For 2005 additional non-recurrent gains and losses in respect of the Group's defined benefit pension schemes have been recorded. These are explained in note 9.

d) Effect of changes in economic assumptions and time value of cost of options and guarantees

Movements in the value of in-force business caused by changes to economic assumptions and the time value of cost of options and guarantees, (which is primarily due to economic experience over the year and changes in economic assumptions) are recorded in non-operating results.

e) Results for fund management operations

The results of the Group's fund management operations include the profits from management of internal and external funds. For EEV basis reporting, Group shareholders' other income is adjusted to deduct the expected margin for the year on management of covered business. The deduction is on a basis consistent with that used for projecting the results for covered business. Group operating profit accordingly includes the variance between actual and expected profit in respect of covered business.

Notes on the EEV basis supplementary information *continued*

4. Accounting presentation

f) Capital held centrally for Asian operations

In adopting the EEV principles Prudential has decided to set encumbered capital at its internal targets for economic capital. In Asia, the economic capital target is substantially higher than the local statutory requirements in total. Accordingly, capital is held centrally for Asian operations. For the purposes of the presentation of the Group's operating results, it is assumed that the centrally held capital is lent interest free to the Asian operations. In turn the results of the Asian operations include the return on that capital and Group shareholders' other income for EEV basis reporting is consequently reduced.

g) Taxation

The EEV profit for the year for covered business is calculated initially at the post-tax level. The post-tax profit is then grossed up for presentation purposes at the effective rate of tax. In general, the effective rate corresponds to the corporation tax rate on shareholder profits of the business concerned. Under achieved profits, except for JNL, this basis also applied. For JNL, under achieved profits pre-tax results were determined by applying the risk discount rate to pre-tax cash flows adjusted for the impact of capital charges.

h) Foreign currency translation

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

The principal exchange rates applied are:

Local currency: £	Closing rate at 31 Dec 2005	Average for 2005	Closing rate at 31 Dec 2004	Average for 2004	Opening rate at 1 Jan 2004
Hong Kong	13.31	14.15	14.92	14.27	13.90
Japan	202.63	200.13	196.73	198.08	191.85
Malaysia	6.49	6.89	7.30	6.96	6.80
Singapore	2.85	3.03	3.13	3.10	3.04
Taiwan	56.38	58.47	60.84	61.10	60.78
US	1.72	1.82	1.92	1.83	1.79

5. Operating profit and margins from new business

a) Profit

	2005			2004		
	Pre-tax £m	Tax £m	Post-tax £m	Pre-tax £m	Tax £m	Post-tax £m
UK insurance operations	243	(73)	170	241	(72)	169
Jackson National Life (note i)	211	(74)	137	145	(51)	94
Asian operations	413	(124)	289	355	(105)	250
Total	867	(271)	596	741	(228)	513
(i) Jackson National Life net of tax profit						
Before capital charge			150			106
Capital charge			(13)			(12)
After capital charge			137			94

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

Included within pre-tax new business profits shown in the table above are profits arising from fund management business falling within the scope of covered business of:

	2005 £m	2004 £m
UK insurance operations	7	10
Jackson National Life	2	4
Asian operations	10	3
Total	19	17

5. Operating profit and margins from new business continued

b) Margins

2005	New business premiums		Annual premium equivalent (APE) £m	Present value of new business premiums (PVNBP) £m	Pre-tax new business contribution £m	New business margin	
	Single £m	Regular £m				(APE) %	(PVNBP) %
UK insurance operations	7,085	191	900	7,593	243	27	3.2
Jackson National Life	5,009	14	515	5,135	211	41	4.1
Asian operations	837	648	731	4,039	413	56	10.2
Total	12,931	853	2,146	16,767	867	41	5.2

2004	New business premiums		Annual premium equivalent (APE) £m	Present value of new business premiums (PVNBP) £m	Pre-tax new business contribution £m	New business margin	
	Single £m	Regular £m				(APE) %	(PVNBP) %
UK insurance operations	6,357	181	817	7,012	241	30	3.4
Jackson National Life	4,408	12	453	4,506	145	32	3.2
Asian operations	662	510	576	3,404	355	62	10.4
Total	11,427	703	1,846	14,922	741	40	5.0

	New business margin (APE)	
	2005 %	2004 %
Asian operations:		
Hong Kong	60	64
Korea	37	36
Taiwan	51	62
India	29	27
Other	74	73
Total Asian operations	56	62

New business premiums reflect those premiums attaching to covered business including premiums for contracts classified as investment products for IFRS basis reporting. New business premiums for regular premium products are shown on an annualised basis. Department of Work and Pensions rebate business is classified as single recurrent premium business. Internal vesting annuity business is classified as new business where the contracts include an open market option.

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

The table above excludes margins for SAIF new business.

New business contributions are determined by applying the economic and non-economic assumptions applying at the end of the year. The contributions represent profits at the end of the year.

Notes on the EEV basis supplementary information continued

6. Operating profit from business in force

	2005 £m	2004 £m
UK insurance operations		
Unwind of discount and other expected returns (note i)	424	351
Cost of strengthened persistency assumption (note ii)	(148)	(73)
Mortality related cost of capital charge (note iii)	(47)	–
Other items (note iv)	(46)	(33)
	183	245
Jackson National Life		
Unwind of discount and other expected returns: (note i)		
On value of in-force and required capital	160	123
On surplus assets (over target surplus)	52	36
Spread experience variance	89	41
Amortisation of interest-related realised gains and losses	53	54
Profit on repricing Term contracts	140	–
Profit (loss) from changes to other operating assumptions	10	(4)
Other	26	(13)
	530	237
Asian operations		
Unwind of discount and other expected returns (note i)	162	120
Change in operating assumptions	(9)	(24)
Experience variances and other items	10	9
	163	105
Total	876	587

Notes

(i) For UK insurance and Asian operations, unwind of discount and other expected returns is determined by reference to the value of in-force business, required capital and surplus assets at the start of the year as adjusted for the effect of changes in economic and operating assumptions reflected in the current year. For the unwind of discount for UK insurance operations included in operating results based on longer-term returns a further adjustment is made. For UK insurance operations the amount represents the unwind of discount on the value of in-force business at the beginning of the year (adjusted for the effect of current year assumption changes), the expected return on smoothed surplus assets retained within the main with-profits fund and the expected return on shareholders' assets held in other UK long-term business operations. Surplus assets retained within the main with-profits fund are smoothed for this purpose to remove the effects of short-term investment volatility from operating results. In the balance sheet and for total profit reporting, asset values and investment returns are not smoothed. For JNL the return on surplus assets is shown separately. Also for JNL the 2004 unwind of discount and 'other' profits have been adjusted by £26 million and £(26) million respectively for refinement to the basis of calculation.

(ii) The £148 million cost of strengthened persistency assumption relates to a number of products, primarily in respect of with-profits bonds. The £73 million cost of strengthened persistency assumption for 2004 relates to the closed book of personal pension policies sold by the now discontinued direct sales force.

(iii) The £47 million charge primarily relates to the cost of capital attaching to liability strengthening on the regulatory basis for annuity business.

(iv) Other charges of £46 million include £45 million of costs associated with complying with regulatory requirements including Sarbanes-Oxley, product and distribution development, £19 million of negative experience variances and other net positive items of £18 million. In determining the appropriate expense assumptions for 2005 account has been taken of the cost synergies that are expected to arise with some certainty from the initiative announced on 1 December 2005 from UK insurance operations working more closely with Egg and M&G. Without this factor there would have been a charge for altered expense assumptions of approximately £55 million. The £33 million charge for other items for 2004 includes £21 million of costs associated with complying with new regulatory requirements and restructuring and £12 million of negative experience variances.

7. Investment return and other income

	2005 £m	2004 £m
IFRS basis	87	44
Less: allocation of investment return on centrally held capital in respect of Asian business to operating result of Asian operations	(21)	(22)
Less: projected fund management result in respect of covered business incorporated in opening EEV value	(24)	(22)
EEV basis	42	0

8. Short-term fluctuations in investment returns

	2005 £m	2004 £m
Long-term business:		
UK insurance operations (note i)	994	408
Jackson National Life (including mark to market value of core structural borrowings) (note ii)	65	103
Asian operations	41	91
Share of investment return of funds managed by PPM America that are consolidated into Group results but attributable to external investors	0	9
Share of profits of venture investment companies and property partnerships of the PAC with-profits fund that are consolidated into Group results but are attributable to external investors	1	9
Movement in mark to market value of core structural borrowings held centrally	(65)	(63)
Other operations	(35)	13
Total	1,001	570

Notes

(i) Short-term fluctuations in investment returns represent for UK insurance operations the difference between actual investment returns in the year attributable to shareholders and the expected returns as described in note 3.

(ii) Short-term fluctuations for JNL comprise:

	2005 £m	2004 £m
Actual investment return on investments less long-term returns included within operating profit:		
Actual realised gains less default assumption and amortisation of interest-related realised gains and losses for fixed maturity securities	5	51
Actual less long-term return on equity-based investments and other items	58	22
Investment return related gain due primarily to changed expectation of profits on in-force variable annuity business in future periods based on current period equity returns*	4	36
Mark to market value of core structural borrowings	(2)	(6)
	65	103

*This adjustment arises due to market returns being higher than the assumed long-term rate of return. This gives rise to higher than expected year end values of variable annuity assets under management with a resulting effect on the projected value of future account values, and hence future profitability.

9. Actuarial and other gains and losses on defined benefit pension schemes

The charge of £47 million (2004: £12 million) included in total profit reflects the shareholders' share of actuarial and other gains and losses on the Group's defined benefit pension schemes. On the EEV basis, this includes a 10 per cent share of the actuarial gains and losses on the share of the deficit attributable to the PAC with-profits fund for the Prudential Staff and Scottish Amicable Pension Schemes. The 2005 charge of £47 million includes a charge of £43 million for altered renewal expense assumptions arising from the prospective increase in employer contributions for the Prudential Staff Pension Scheme for future service of active members (as distinct from deficit funding).

10. Effect of changes in economic assumptions and time value of cost of options and guarantees

The profits (losses) on changes in economic assumptions and time value of cost of options and guarantees resulting from changes in economic factors for in-force business included within the profit on ordinary activities before tax arise as follows:

	2005			2004		
	Change in economic assumptions £m	Change in time value of cost of options and guarantees £m	Total £m	Change in economic assumptions £m	Change in time value of cost of options and guarantees £m	Total £m
UK insurance operations	(81)	31	(50)	40	46	86
Jackson National Life	(3)	11	8	(53)	6	(47)
Asian operations (note i)	(265)	5	(260)	(113)	26	(87)
Total	(349)	47	(302)	(126)	78	(48)

Note

(i) Consistent with prior periods for the Taiwan operation, the projections include an assumption of phased progression of the bond yields of around 2 per cent towards 5.5 per cent at 31 December 2012 as described in note 3b(ii). This takes into account the effect on bond values of interest rate movements. The principal cause of the £265 million charge for the effect of changed economic assumptions is the reduction in short-term earned rates in Taiwan. This reduction has the effect of delaying the emergence of the expected long-term rate.

Notes on the EEV basis supplementary information *continued*

11. Taxation charge

The tax charge comprises:

	2005 £m	2004 £m
Tax on operating profit from continuing operations		
Long-term business:		
UK insurance operations	127	142
Jackson National Life	204	116
Asian operations*	162	119
	493	377
Other operations	(130)	(27)
Total tax charge on operating profit from continuing operations	363	350
Tax on items not included in operating profit		
Tax charge on short-term fluctuations in investment returns	343	189
Tax credit on actuarial and other gains and losses of defined benefit pension schemes	(14)	(5)
Tax (credit) charge on effect of changes in economic assumptions and time value of cost of options and guarantees	(39)	19
Total tax charge on items not included in operating profit from continuing operations	290	203
Tax charge on profit on ordinary activities from continuing operations (including tax on actual investment returns)	653	553

* Including tax relief on development expenses.

The profit for the year for covered business is in most cases calculated initially at the post-tax level. The post-tax profit for covered business is then grossed up for presentation purposes at the effective rates of tax applicable to the countries and years concerned. In the UK this is the UK corporation tax rate of 30 per cent. For JNL the federal rate of 35 per cent is applied to gross up movements on the value of in-force business. Effects on statutory tax for the period affect the overall tax rate. For Asia, similar principles apply subject to the availability of taxable profits.

12. Earnings per share (EPS)

	2005 £m	2004 £m
Operating EPS from continuing operations:		
Operating profit before tax	1,712	1,274
Tax	(363)	(350)
Minority interests	(10)	(8)
Operating profit after tax and minority interests from continuing operations	1,339	916
Operating EPS from continuing operations	56.6p	43.2p
Total EPS from continuing operations:		
Total profit before tax	2,244	1,784
Tax	(653)	(553)
Minority interests	(12)	(26)
Total profit after tax and minority interests from continuing operations	1,579	1,205
Total EPS from continuing operations	66.8p	56.8p
Average number of shares (millions)	2,365	2,121

13. Shareholders' funds – segmental analysis

	2005 £m	2004 £m
UK operations		
Long-term business operations (notes ii and iii):		
Smoothed shareholders' funds (note i)	4,558	4,067
Actual shareholders' funds less smoothed shareholders' funds	574	161
EEV basis shareholders' funds	5,132	4,228
M&G (note vii):		
Net assets of operations	245	297
Acquired goodwill (note v)	1,153	1,153
Egg (note vii)	303	273
	6,833	5,951
US operations		
Jackson National Life (net of surplus note borrowings of £183m (2004: £162m) note vi):		
Before capital charge:		
Excluding assets in excess of target surplus	2,566	1,817
Assets in excess of target surplus	899	769
	3,465	2,586
Capital charge (note iv)	(117)	(80)
After capital charge	3,348	2,506
Broker-dealer, fund management and Curian operations (note vii)	70	64
	3,418	2,570
Asian operations		
Long-term business (note ii):		
Net assets of operations – EEV basis shareholders' funds	1,988	1,565
Acquired goodwill (note v)	111	231
Fund management (note vii):		
Net assets of operations	82	66
Acquired goodwill (note v)	61	61
	2,242	1,923
Other operations		
Holding company net borrowings (note vi)	(1,724)	(1,299)
Pension scheme deficits (net of tax) attributable to shareholders (note vii)	(142)	(152)
Other net liabilities (note vii)	(326)	(379)
	(2,192)	(1,830)
Total	10,301	8,614

Notes

(i) UK long-term business smoothed shareholders' funds reflect an adjustment to the assets of the PAC with-profits sub-fund, for the purposes of determining the unwind of discount included in operating profits, to remove the short-term volatility in market values of assets. Shareholders' funds in the balance sheet are determined on an unsmoothed basis.

(ii) A charge is deducted from the annual result and balance sheet value for the cost of capital for the Group's long-term business operations. The cost is the difference between the nominal value of solvency capital and the present value, at risk discount rates, of the projected releases of this capital and the investment earnings on the capital. Where solvency capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its release over time and no further adjustment is necessary in respect of solvency capital.

(iii) The proportion of surplus allocated to shareholders from the UK with-profits business has been based on the present level of 10 per cent. Future bonus rates have been set at levels which would fully utilise the assets of the with-profits fund over the lifetime of the business in force.

(iv) In determining the cost of capital of JNL, it has been assumed that an amount equal to 235 per cent of the risk-based capital required by the National Association of Insurance Commissioners (NAIC) at the Company Action Level must be retained. The impact of the related capital charge is to reduce JNL's shareholders' funds by £117 million (2004: £80 million).

(v) Under IFRS, subject to impairment testing, goodwill is no longer amortised from the date of adoption i.e. 1 January 2004. Acquired goodwill of the Japan life business has been subject to an impairment charge included in the 2005 results of £120 million.

Goodwill attaching to venture fund investment subsidiaries of the PAC with-profits fund that are consolidated under IFRS are not included in the table above as the goodwill attaching to these companies is not relevant to the analysis of shareholders' funds.

Notes on the EEV basis supplementary information *continued*

13. Shareholders' funds – segmental analysis *continued*

Notes *continued*

(vi) Net core structural borrowings of shareholder-financed operations comprise:

	2005 £m	2004 £m
Holding company cash and short-term investments	1,128	1,561
Core structural borrowings – central funds	(2,852)	(2,860)
Holding company net borrowings	(1,724)	(1,299)
Core structural borrowings – Jackson National Life	(183)	(162)
	(1,907)	(1,461)

The altered carrying value of core structural borrowings under EEV reflects the application of market values rather than IFRS basis values.

(vii) With the exception of the share of pension scheme deficits attributable to the PAC with-profits fund, the amounts shown for the items in the table above that are referenced to this note have been determined on the statutory IFRS basis. The deficit for the defined benefit pension scheme reflects the statutory net of tax IFRS provision of £113 million (2004: £105 million), augmented by £29 million (2004: £47 million) for the shareholders' share of the net of tax deficit attributable to the PAC with-profits fund.

14. Reconciliation of movement in shareholders' funds

	Long-term business operations			Total long-term business operations £m	Other operations £m	Group total £m
	UK insurance operations £m	JNL £m	Asian operations £m			
Operating profit (including investment return based on long-term rates of returns)						
Long-term business:						
New business (note 5)	243	211	413	867		867
Business in force (note 6)	183	530	163	876		876
	426	741	576	1,743		1,743
Asia development expenses			(20)	(20)		(20)
M&G					163	163
Egg					44	44
Asian fund management operations					12	12
US broker-dealer and fund management					24	24
Curian					(10)	(10)
Other income and expenditure					(244)	(244)
Operating profit (loss) from continuing operations	426	741	556	1,723	(11)	1,712
Goodwill impairment charge					(120)	(120)
Short-term fluctuations in investment returns (note 8)	995	65	41	1,101	(100)	1,001
Actuarial and other gains and losses on defined benefit pension schemes (note 9)	(43)		3	(40)	(7)	(47)
Effect of changes in economic assumptions and time value of cost of options and guarantees (note 10)	(50)	8	(260)	(302)		(302)
Profit (loss) on ordinary activities before tax (including actual investment returns)	1,328	814	340	2,482	(238)	2,244
Tax on profits (losses) from continuing operations (note 11):						
Tax on operating profit	(127)	(204)	(162)	(493)	130	(363)
Tax on short-term fluctuations in investment returns	(299)	(23)	(12)	(334)	(9)	(343)
Tax on actuarial and other gains and losses on defined benefit pension schemes	13		0	13	1	14
Tax on effect of changes in economic assumptions and time value of cost of options and guarantees	15	(3)	27	39		39
Total tax (charge) credit	(398)	(230)	(147)	(775)	122	(653)
Discontinued operations (net of tax)					3	3
Minority interests	(2)			(2)	(10)	(12)
Profit (loss) for the financial year	928	584	193	1,705	(123)	1,582
Transition adjustment, net of tax, on adoption of IAS 32, IAS 39 and IFRS 4 at 1 January 2005					(25)	(25)
Unrealised valuation movements on securities classified as available-for-sale					(1)	(1)
Movement in cash flow hedges					(4)	(4)
Exchange movements		318	190	508	(131)	377
Related tax					65	65
Development costs included above (net of tax) borne centrally			2	2	(2)	
Intra group dividends (including statutory transfer)	(234)	(226)	(53)	(513)	513	
External dividends					(380)	(380)
Reserve movements in respect of share-based payments					15	15
Investment in operations (note i)	224	170	107	501	(501)	
Adjustment for net of tax losses of Curian subsidiary owned by JNL		(2)		(2)	2	
Adjustment for economic capital for Asian operations held centrally			(15)	(15)	15	
Adjustment for net of tax fund management projected profits of covered business	(14)	(2)	(1)	(17)	17	
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS					3	3
Proceeds from issues of share capital by parent company					55	55
Net increase in shareholders' capital and reserves	904	842	423	2,169	(482)	1,687
Shareholders' capital and reserves at 1 January 2005	4,228	2,506	1,565	8,299	315	8,614
Shareholders' capital and reserves at 31 December 2005 (note 13)	5,132	3,348	1,988	10,468	(167)	10,301

Notes

(i) Investment in operations reflects increases in share capital. This includes certain non-cash items as a result of timing differences.

Notes on the EEV basis supplementary information *continued*

14. Reconciliation of movement in shareholders' funds *continued*

	Long-term business operations			Total long-term business operations £m	Other operations £m	Group total £m
	UK insurance operations £m	JNL £m	Asian operations £m			
EEV basis shareholders' funds at 31 December 2005						
Analysed as:						
Statutory IFRS basis shareholders' funds	1,141	2,899	1,034	5,074	120	5,194
Additional retained profit on an EEV basis	3,991	449	954	5,394	(287)	5,107
EEV basis shareholders' funds at 31 December 2005	5,132	3,348	1,988	10,468	(167)	10,301
Comprising:						
Free surplus	148	899	(212)	835		
Required capital	710	1,198	974	2,882		
Value of in-force business before deduction of cost of capital and of guarantees	4,529	1,511	1,771	7,811		
Cost of capital	(192)	(117)	(539)	(848)		
Cost of time value of guarantees	(63)	(143)	(6)	(212)		
	5,132	3,348	1,988	10,468		

	Long-term business operations			Total long-term business operations £m	Other operations £m	Group total £m
	UK insurance operations £m	JNL £m	Asian operations £m			
EEV basis shareholders' funds at 1 January 2005						
Analysed as:						
Statutory IFRS basis shareholders' funds*	877	2,568	750	4,195	520	4,715
Additional retained profit on an EEV basis	3,351	(62)	815	4,104	(205)	3,899
EEV basis shareholders' funds at 1 January 2005	4,228	2,506	1,565	8,299	315	8,614
Comprising:						
Free surplus	142	769	(275)	636		
Required capital	495	955	814	2,264		
Value of in-force business before deduction of cost of capital and of guarantees	3,798	963	1,432	6,193		
Cost of capital	(123)	(80)	(382)	(585)		
Cost of time value of guarantees	(84)	(101)	(24)	(209)		
	4,228	2,506	1,565	8,299		

* Statutory basis shareholders' funds at 1 January 2005 reflect the adoption of IAS 32, IAS 39 and IFRS 4.

15. Reconciliation of net worth and value of in-force business

	Free surplus £m	Required capital £m	Total net worth (note i) £m	Value of in-force business (note ii) £m	Total long-term business £m
Reconciliation of net worth and value of in-force business for 2005					
Shareholders' capital and reserves at 1 January 2005	636	2,264	2,900	5,399	8,299
New business contribution (note iii)	(562)	409	(153)	749	596
Expected return on existing business	5		5	566	571
Existing business – transfer to net worth	850	(146)	704	(704)	–
Changes of operating assumptions and experience variances	46	10	56	7	63
Changes of non-operating assumptions and experience variances	(161)	143	(18)	493	475
Profit after tax from continuing operations	178	416	594	1,111	1,705
Exchange rate movements	69	191	260	248	508
Discontinued operations, net of tax					
Amounts injected, released and transferred to (from) life and related businesses	(48)	11	(37)	(7)	(44)
Shareholders' capital and reserves at 31 December 2005	835	2,882	3,717	6,751	10,468

Notes

(i) Net worth consists of statutory solvency capital (or economic capital where higher) and unencumbered capital.

(ii) Value of in-force business includes the value of future margins from current in-force business less the cost of holding encumbered capital.

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

	2005 £m	2004 £m
Free surplus	(562)	(502)
Required capital	409	390
Total net worth	(153)	(112)
Value of in-force	749	625
Total long-term business	596	513

(iv) Included in the EEV basis shareholders' funds of long-term business operations of £10,468 million (2004: £8,299 million) is £174 million (2004: £200 million) in respect of fund management business falling within the scope of covered business as follows:

	2005 £m	2004 £m
UK insurance operations	120	123
Jackson National Life	12	20
Asian operations	42	57
	174	200

Notes on the EEV basis supplementary information *continued*

16. Sensitivity of results to alternative assumptions

a) Sensitivity analysis – economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2005 (2004) and the new business contribution after the effect of required capital for 2005 and 2004 to:

- 1 per cent increase in the discount rates;
- 1 per cent increase and decrease in interest rates, including all consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets, risk discount rates);
- 1 per cent rise in equity and property yields;
- 10 per cent fall in market value of equity and property assets (not applicable for new business contribution); and
- holding company statutory minimum capital (by contrast to economic capital).

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

	UK insurance operations £m	JNL £m	Asian operations £m	Total long-term £m
2005				
New business profit for 2005				
As reported (note 5)	243	211	413	867
Discount rates – 1% increase	(49)	(27)	(46)	(122)
Interest rates – 1% increase	(4)	2	(6)	(8)
Interest rates – 1% decrease	(5)	(26)	3	(28)
Equity/property yields – 1% rise	13	24	20	57
Embedded value of long-term operations at 31 December 2005				
As reported (note 14)	5,132	3,348	1,988	10,468
Discount rates – 1% increase	(432)	(133)	(236)	(801)
Interest rates – 1% increase (note i)	108	(144)	49	13
Interest rates – 1% decrease (note i)	(142)	55	(126)	(213)
Equity/property yields – 1% rise	297	42	136	475
Equity/property market values – 10% fall	(480)	(85)	(75)	(640)
Statutory minimum capital	0	79	431	510

Note

(i) 2005

	Embedded value of long-term operations £m	Interest rates		% of embedded value	
		1% increase £m	1% decrease £m	1% increase %	1% decrease %
Asian operations					
Established markets	1,844	(57)	49	(3)	3
Taiwan*	(311)	106	(174)	34	(56)
Korea	136	(3)	3	(2)	2
Vietnam	127	3	(2)	2	(2)
Other	192	0	(2)	0	(1)
	1,988	49	(126)	2	(6)

* Taiwan sensitivity to starting bond rates (i.e. the starting bond rate for the progression to the assumed long-term rate):

	Embedded value at 31 Dec 2005 £m	1% increase in the starting bond rates £m	1% decrease in the starting bond rates £m
Taiwan	(311)	104	(108)

16. Sensitivity of results to alternative assumptions continued

2004	UK insurance operations £m	JNL £m	Asian operations £m	Total long-term £m
New business profit for 2004				
As reported (note 5)	241	145	355	741
Discount rates – 1% increase	(40)	(22)	(42)	(104)
Interest rates – 1% increase	(4)	(1)	(5)	(10)
Interest rates – 1% decrease	(1)	(33)	3	(31)
Equity/property yields – 1% rise	13	16	13	42
Embedded value of long-term operations at 31 December 2004				
As reported (note 14)	4,228	2,506	1,565	8,299
Discount rates – 1% increase	(366)	(83)	(218)	(667)
Interest rates – 1% increase	144	(109)	(14)	21
Interest rates – 1% decrease	(179)	30	(32)	(181)
Equity/property yields – 1% rise	264	24	98	386
Equity/property market values – 10% fall	(416)	(54)	(44)	(514)
Statutory minimum capital	0	43	326	369

b) Sensitivity analysis – non-economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2005 (2004) and the new business contribution after the effect of required capital for 2005 and 2004 to:

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

2005	UK insurance operations £m	JNL £m	Asian operations £m	Total long-term £m
New business profit for 2005				
As reported (note 5)	243	211	413	867
Maintenance expenses – 10% decrease	8	5	10	23
Lapse rates – 10% decrease	7	18	39	64
Mortality and morbidity – 5% decrease	(39)	5	13	(21)
Change representing effect on:				
Life business	1	2	13	16
Annuity business*	(40)	3	0	(37)
Embedded value of long-term operations for 2005				
As reported (note 14)	5,132	3,348	1,988	10,468
Maintenance expenses – 10% decrease	33	36	45	114
Lapse rates – 10% decrease	68	90	87	245
Mortality and morbidity – 5% decrease	(62)	90	69	97
Change representing effect on:				
Life business	9	83	69	161
Annuity business*	(71)	7	0	(64)

* The JNL annuity sensitivity for mortality and morbidity relates to variable annuity business.

Notes on the EEV basis supplementary information *continued*

16. Sensitivity of results to alternative assumptions *continued*

2004	UK insurance operations £m	JNL £m	Asian operations £m	Total long-term £m
New business profit for 2004				
As reported (note 5)	241	145	355	741
Maintenance expenses – 10% decrease	7	4	12	23
Lapse rates – 10% decrease	9	13	28	50
Mortality and morbidity – 5% decrease	(24)	3	8	(13)
Change representing effect on:				
Life business	1	1	8	10
Annuity business*	(25)	2	0	(23)
Embedded value of long-term operations for 2004				
As reported (note 14)	4,228	2,506	1,565	8,299
Maintenance expenses – 10% decrease	32	33	45	110
Lapse rates – 10% decrease	67	44	78	189
Mortality and morbidity – 5% decrease	(68)	69	43	44
Change representing effect on:				
Life business	3	65	43	111
Annuity business*	(71)	4	0	(67)

*The JNL annuity sensitivity for mortality and morbidity relates to variable annuity business.

17. Reconciliation of 2004 achieved profits basis results to EEV basis results

New business profits

	UK insurance operations £m	JNL £m	Asian operations £m	2004 Total £m
Impact of adoption of EEV basis:				
Changes in economic assumptions	10	(8)	(5)	(3)
Cost of time value of options and guarantees	(5)	(29)	4	(30)
Changes in risk discount rates	6	30	55	91
Fund management business falling within the scope of covered business	10	4	3	17
Other changes	0	(8)	(14)	(22)
Total changes	21	(11)	43	53
Achieved profits basis operating profit from new business – as previously published	220	156	312	688
EEV basis operating profit from new business	241	145	355	741

Investment return and other income

	2004 Total £m
Impact of adoption of EEV basis:	
Allocation of investment return on centrally held capital, in respect of Asian businesses to operating result of Asian operations	(22)
Projected fund management result for 2004 in respect of covered business incorporated in opening EEV value	(22)
Total changes	(44)
Achieved profits and IFRS basis result	44
EEV basis	0

17. Reconciliation of 2004 achieved profits basis results to EEV basis results continued
Shareholders' funds (excluding minority interests) at 31 December 2004

	2004 Total £m
Changes consequent on adoption of IFRS:	
Timing difference on recognition of dividend declared after balance sheet date	253
Shareholders' share of deficit of UK defined benefit pension schemes (net of deferred tax):	
Statutory IFRS basis	(115)
Additional charge for shareholders' 10% interest on the achieved profits basis in the deficit attributable to the PAC with-profits fund	(47)
Goodwill	94
Other items (net of related tax)	(20)
Total changes	165
Achieved profits basis shareholders' funds, net of minority interests – as previously published	8,596
Achieved profits basis shareholders' funds, net of minority interests – as restated for the adoption of IFRS	8,761
Impact of adoption of EEV basis:	
Changes in economic assumptions	32
Changes in the cost of required capital	(269)
Cost of time value of options and guarantees	(209)
Changes in risk discount rates	427
Fund management business falling within the scope of covered business	200
Marking core structural borrowings to market value	(225)
Other changes	(103)
Total changes	(147)
EEV basis shareholders' funds, net of minority interests	8,614