Group Chief Executive's report

Group

'As well as reaffirming our strategy, these results also reflect the operational expertise and excellence that our operating divisions around the world bring to bear, and fully justify our commitment to nurturing the financial strength of the Group through prudent management of capital resources.'

Mark Tucker
Group Chief Executive

I am pleased to report that Prudential delivered a strong performance in all its businesses in 2008, and maintained a healthy capital position despite the banking liquidity crisis in mid-year and the onset of the most severe worldwide recession in more than a generation.

This achievement once again demonstrated the soundness of the strategy the Group has followed in recent years. Our selective spreading of geographic risk across different continents and types of economy, our focus on the most profitable opportunities in the pre- and post-retirement sector in each of our chosen markets, and our resolute refusal to pursue sales volume targets at the expense of profit have once again proved their worth. We have said in the past that this is a formula for outperformance, and this has held true amid the particularly testing conditions of recent months.

As well as reaffirming our strategy, these results also reflect the operational expertise and excellence that our operating divisions around the world bring to bear, and fully justify our commitment to nurturing the financial strength of the Group through prudent management of capital resources.

Before describing our performance for 2008 in detail, I would like to make a brief comment on my decision to leave Prudential at the end of September 2009 after four and a half years as Group Chief Executive and a total of 25 years with the Group. This was not an easy decision, but I believe the Group's continued progress in 2008 confirms the success of the measures taken over the last four years to strengthen the Group's financial and strategic positioning, and having achieved this the time seems opportune to step aside so that the Board can entrust the next stage of the Group's development to a successor with a full term ahead of him.

I am deeply proud of what the team here has achieved under my leadership, and am also deeply impressed by the quality of my successor, our current Chief Financial Officer, Tidjane Thiam. Going forward, I know Tidjane will do an outstanding job as Group Chief Executive.

Group performance

Turning to our performance during 2008, our Group operating profit before tax from continuing operations, on the European Embedded Value (EEV) basis, rose to £2,961 million, an increase of 17 per cent. This means our EEV operating profit before tax has grown at a compound annual rate of 25 per cent since the end of 2004. The Group's return on embedded value was 15.0 per cent (2007: 15.4 per cent).

On the statutory International Financial Reporting Standards (IFRS) basis, operating profit before tax from continuing operations increased by 12 per cent to £1,347 million. As a result, our IFRS operating profit before tax has now grown at a compound annual rate of 21 per cent since the end of 2004.

Operating profit in the Group's asset management operations increased by £11 million to £345 million in very difficult trading conditions in all markets. Net inflows at M&G were £3.4 billion and our asset management business in Asia recorded net inflows of £0.9 billion.

Equally important, our Group capital position remains robust. Using the regulatory measure of the Insurance Groups Directive (IGD), the Group's capital surplus was estimated at £1.7 billion with a solvency ratio of 162 per cent. Through an innovative transaction we have been allowed by the regulator to include £0.3 billion of the shareholders' economic interest in the future transfers from the UK With-Profits Fund, which in total was worth £1.7 billion at 31 December 2008. Going forward, there is the opportunity to develop similar transactions which may allow us to access more of the residual £1.4 billion if required.

Our IGD position will be further strengthened during 2009 by around £0.8 billion on completion of the transfer of the agency back-book business in Taiwan, a transaction that we announced on 20 February 2009.

In addition to this strong capital position, the total credit reserve for the UK annuity shareholder business is £1.4 billion.

We also retain significant flexibility and capacity for other management actions to improve and protect our position still further, were the need to arise.

Taking all these factors into account alongside our proactive approach to risk management, we are confident that our Group remains resilient to any further deterioration in market conditions across all asset classes.

Our cash flow position has been improving over a number of years, and in 2008 we achieved our target of being operating cash flow positive at the Group level, with a cash surplus of £54 million.

Given this robust financial position, the Board has recommended a final dividend of 12.91 pence per share, bringing the full-year dividend to 18.90 pence per share, an increase of five per cent. The dividend is covered 2.24 times by post-tax IFRS operating profit from continuing operations.

EEV operating profit from continuing operations before tax £m

IFRS operating profit from continuing operations before tax £m

Group Chief Executive's report
continued

Our strategy
The Group's overriding objective remains the generation of sustainable value for our shareholders, resulting from sound strategic positioning to capture long-term growth opportunities in the pre- and post-retirement market, combined with a focused approach to delivering the optimal level of capital-efficient profitable growth in the short and medium term.

The bedrock of our strategy is to be both highly international and very selective. We look to maintain an internationally diverse portfolio of businesses, embracing countries that are at different stages of economic development but which all share one key attribute: the opportunity for us to build a market-leading operation with prospects for sustainable long-term profitable growth and a superior rate of return on capital. In every market we choose to enter, we also benefit from an operating model that enables each of our businesses to stay close to its customers and their needs when formulating product and distribution strategies, while taking a consistent, disciplined Group-wide global approach to managing risk, capital and cash.

Within this proven framework, we maintain a strong and consistent focus on the retirement savings, income and protection sectors. This has many different facets, ranging from providing regular savings products that accumulate funds for retirement, through healthcare protection at all ages, to helping those entering or already in retirement to organise their finances so as to secure an efficient retirement income. As demographic and welfare trends worldwide continue to reinforce the need for personal savings to provide income in retirement, and as the 'baby-boomer' generation in the Western world makes the transition from employment into retirement, our strong presence, assets and capabilities in the sector will position us to capture a disproportionate share of this growing profit pool over the coming years.

The Group's particularly strong association with the Asian region, which has been our primary focus for investment and expansion in recent years, has also been vindicated by recent events. Of course, Asian markets did feel the impact of the global financial turmoil in mid-2008, and the region's economic performance has undoubtedly suffered as a consequence of the downturn in Western markets for its goods. Nevertheless, Asia was the only region worldwide to record high single-digit economic growth in 2008. Going forward, we believe that Asia's fundamentals of continued economic growth, increasing mass affluence and shifting demographics will continue to be powerful drivers of profitable growth in the future. In line with our stated strategy to review acquisition opportunities, we did look at AIA's assets in Asia. Following careful consideration against our strict financial criteria and our strategic objectives, we decided not to proceed with an offer for any of these assets.

The US remains the largest retirement market in the world, validating our strategy to position Jackson to meet the pre- and post-retirement needs of the baby-boomer generation. As in the UK, the retirement and near-retirement population will represent the fastest growing segment of the market in the US over the next decade.

Overall we believe that our strategy, and the consistency with which we execute it, are the core factors that differentiate us from our peers.

Product and distribution strategy
In all our operations, our aim is to have a suite of products that delivers good value and meets customers' needs without being unduly capital intensive or leaving the Group overly exposed to the economic cycle. While we would not claim to be recession-proof, we have shown that we are recession-resistant. The need to fund retirement savings and provide for income in retirement is not going to go away – and this makes our revenue streams highly resilient, even though at different points in the cycle customers may prefer to achieve their goals through different products and investment options.

Market dynamics

People are living longer
More active retirement
People want to retire at an earlier age
Underestimating savings required for retirement
Increased cost of long-term care
Reduction and withdrawal of state pension benefits
Protection of purchasing power

Need for more long-term savings

Need for income and protection in retirement

In Asia, we continued to benefit in 2008 from our focus on regular premium products, as sales of single premium products suffered amid the market dislocation experienced in the second half of the year. In addition, the breadth of our offering enabled us to refocus our energies on higher-margin health and protection products, and also on with-profits for the more cautious investor.

In the US, the prevailing economic uncertainty and equity market volatility had a negative impact on variable annuity sales in 2008. However, fixed annuity product sales increased as customers became more risk averse. Jackson's strength across the annuity product range enabled us to anticipate this change and meet shifting demand. We executed this change while maintaining our disciplined approach to pricing, despite intense price pressures in the variable annuity market. Our successful hedging of variable annuity guarantees meant our equity hedging gains more than offset the drop in equity markets during the year.

During 2008, Prudential's UK Insurance Operations benefited from our strength in the individual annuity market, supported by a significant flow from internal vesting pensions and continuing high conversion rates.

At the same time, with consumers seeking greater security and stability amid unprecedented market volatility, the financial strength of our with-profit funds and our long-term investment performance, proved to be further advantages. We remain a market leader in both individual annuities and with-profits, as well as in the corporate pensions market and the emerging equity release market.

Across our asset management businesses we have broad multi-asset capabilities covering all asset classes. Once again, these enable us to tailor our offerings to changing market conditions and customer preferences. M&G's investment performance and distribution strength were key drivers behind M&G's robust profits, net sales performance and clear relative outperformance.

We are also maintaining our proud track record of innovation in product design. In the UK in 2008 we introduced an income drawdown product and enhanced lifestyle pricing for annuities. And we continued to build on our success in the with-profits sector by extending our multi-asset capabilities across additional product structures. In Asia we continue to build our health and protection product range, and have enjoyed great success in developing Shariah-compliant products in both Indonesia and Malaysia.

Our operating model also enables us to be flexible in distribution, identifying and developing the specific distribution mix that will create the optimal value in each market. In Asia, for example, we are unique in that we have developed both the largest regional network of tied agents and also excellent partnerships with Standard Chartered and many other banks across the region. In the United States, our highly successful distribution model focuses on our industry leading wholesaler teams, who offer genuine added-value to the independent financial advisor channel while also distributing products through Regional Broker Dealers and banks. In the UK, we have a diverse multi-channel approach including direct sales, financial advisers and partnerships.

In asset management, our businesses achieve similar flexibility through a multi-channel, multi-geography distribution approach in both the retail and institutional marketplaces.

A further manifestation of our flexibility is our portfolio of valuable, market-leading brands. Brands create value through their relationship and resonance with customers. Whether you look at Prudential, Jackson, M&G or any of our other brands, each has a clear personality and values that helps us build and sustain customer loyalty and trust. The benefits of this trust were especially apparent in 2008, when the collapse in consumer confidence in the financial services sector saw us benefit from a concerted 'flight to quality'.

Risk and capital management

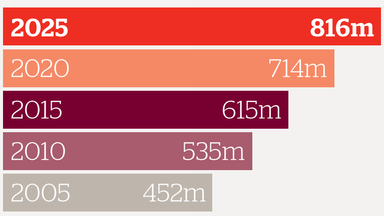
The events of 2008 have put the balance sheets and capital positions of all insurance companies under close scrutiny. Few anticipated the depth of the banking crisis or the speed of onset of recession in the western economies. But at Prudential we entered 2008 in a generally defensive mode in expectation of a general downturn in the economic outlook – and this certainly stood us in good stead as events unfolded.

Despite the downturn, the capital position of the Group remained strong in 2008, in the face of a testing combination of highly volatile and declining equity markets, falling interest rates, widening spreads on corporate bonds, and rapidly deteriorating credit conditions. Our defensive stance on credit exposure in particular served us well – as did the comprehensive equity hedging strategies that we had put in place in the US to protect against product guarantees.

Projection of population aged 55+ (million)

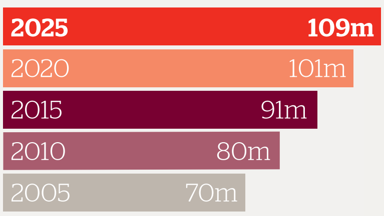
Asia

Asian households are changing rapidly: they are becoming wealthier, smaller and older, with a growing need for financial solutions.



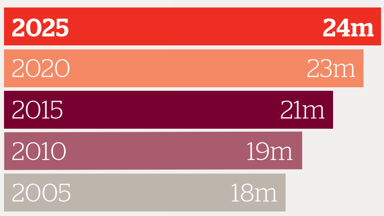
United States

As 78 million baby-boomers move in to retirement age, their assets will shift from asset accumulation to income distribution.



United Kingdom

The retirement and near-retirement population will represent the fastest-growing segments of the market over the next 10 years.



Given the crisis in the global banking industry in 2008, it is worth restating the fundamental differences between life insurers and banks – a distinction that extends to the two industries' business models, capital ratios and regulatory needs. Insurers do not borrow short and lend long, do not give out credit, are structurally long in terms of liquidity, and are much better able to hold assets to maturity without risk of forced selling at depressed prices.

Equally important, at Prudential effective capital and risk management are central to our approach to managing the Group. We took to heart the lessons from the last downturn in 2002 and 2003, and responded by improving our skills base, reducing concentration levels, and managing our exposures prudently, but proactively. These measures paid off in 2008.

During the year we also took the decision not to proceed with the reattribution of the inherited estate in the UK With-Profits Sub-Fund of Prudential Assurance Company. This decision was taken after an exhaustive review of the potential benefits and disadvantages of such a move for policyholders and shareholders, the conclusion from which was that it would be in their best long-term interests to maintain the strength and stability inherent in the status quo. This cautious approach on behalf of policyholders and investors was supported at the time by most market commentators, and has been amply vindicated by subsequent events.

We also remain comfortable with the Group's liquidity position at both holding and subsidiary company level. The holding company has significant internal sources of liquidity. As well as cash and near-cash assets of £1.2 billion – more than sufficient to meet all our requirements for the foreseeable future – the Group also has in place £2.1 billion of undrawn committed banking facilities.

One result of our consistently cautious capital and cash management strategy is our ability to maintain our conservative dividend policy, as reflected in the dividend announced with these results. Going forward, our Board will continue to focus on delivering a growing dividend, the size of which will of course continue to reflect the Board's view at the time of the Group's financial position and needs, including available opportunities for profitable investment. The Board believes that, in the medium term, a dividend cover of around two times is appropriate to maintain a progressive, though conservative, dividend policy.

2008 Priorities

Group

- Group holding company operating cash flow positive in 2008
- Maintain robust capital position
- Deliver growing dividend, determined after taking into account the Group's financial flexibility and opportunities to invest in areas of business offering attractive returns
- Targeting 2 times cover over time

Asia

- Expand the agency force and continue to improve productivity
- Maximise the potential from non-agency distribution and add new partners
- Further develop direct marketing channels and up-sell and cross-sell
- Increase focus on retirement services and health products

United States

- Continue to innovate around our key variable annuity product
- Enhance further our already world-class service model
- Expand retail distribution

United Kingdom

- Build on our strengths in the retirement market and risk products
- Migrate to factory gate cautiously managed asset accumulation products
- Deliver on the cost reduction programme including the outsource programme
- Selectively participate in the wholesale market
- Determine whether it is in the best interests of policyholders and shareholders to pursue a reattribution of the inherited estate

Asset management

- Maintain superior investment performance for both internal and external funds
- Extend third-party retail and institutional business

2008 Achievements

- Operating cash flow was positive £54 million in 2008
- Through prudent and proactive management the Group's Insurance Groups Directive (IGD) surplus is estimated at £1.7 billion
- The surplus will increase by approximately £0.8 billion on completion of disposal of the Group's agency business in Taiwan
- Full Year dividend increased by five per cent
- Dividend cover of 2.24 times

- Increased average number of agents in the region to 425,000 with the largest increases in Indonesia up 43 per cent to 57,000 and India up 21 per cent to 287,000. Aside from Thailand, all operations grew their agency forces
- Successful bank distribution agreement with Standard Chartered Bank (SCB) was expanded and extended. Prudential now works with SCB in nine markets[1] and is now exploring more opportunities for protection and Takaful products

1 Hong Kong, Singapore, Malaysia, Taiwan, Japan, Korea, Thailand, China, Vietnam

- Continued to develop and launch new retirement orientated products. For example in Korea and Malaysia variable annuity products were launched that provide a guaranteed minimum income on retirement
- Health products have been incorporated into agency incentive programmes, a standalone health care product was launched into the SCB channel with simplified underwriting and eye-catching media campaigns to capture direct business and provide leads for other channels

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- We introduced three new guaranteed minimum withdrawal benefits (GMWB) and eight new portfolio investment options
- Implementation of dedicated, premier service teams resulted in overwhelmingly positive feedback from key producers
- Jackson recognised as World Class service provider by the Service Quality Management in its latest benchmarking study of North American contact centres
- Retained and strengthened distribution relationships by providing the resources, guidance and services, advisers need most during difficult times
- Curian Capital, added such a large volume of new selling agreements during 2008 that we needed to expand its wholesaling force, which was already the largest in the managed accounts business

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- We maintained our leadership position in the individual annuity market in 2008 with a market share of 24 per cent. During the year, we introduced lifestyle pricing and launched a new enhanced annuity product. We grew our lifetime mortgage market share to 23 per cent and the PruHealth joint venture continues to develop strongly. With-profits bond sales were particularly strong in 2008, reflecting the strength of our with-profits offering and an increasing demand for this type of product as consumers increasingly look to protect themselves from market downturns
- We launched PruFund as a fund link, making it available across a range of tax wrappers including our factory gate products – individual pensions, income drawdown, onshore and offshore bonds. In addition, we launched PruSelect, an extended range of unit-linked funds across the pensions and investments products to complement our in-house multi-asset fund range, and these have helped us grow our market share across all these product sets. We have also gained over 40 new distribution panels with 15 key accounts, enabling us to distribute our factory gate products more widely with intermediaries
- The agreement with Capita to outsource a large proportion of our policy administration began in April 2008 and we are on track to deliver the targeted £195 million of cost savings from the end of 2010
- The transactions completed included the bulk annuity buy-in agreements with Goldman Sachs for the reinsurance of APE £30 million of Rothesay Life's non-profit annuity business and with the Trustee of the Cable & Wireless Superannuation Fund for the reinsurance of APE £106 million of liabilities relating to the scheme's pensioners in payment. Our new business margin on our Wholesale bulk annuity and insurer backbook business was 32 per cent
- After extensive assessment, we concluded that maintaining the current operating model for the With-Profits Sub-Fund was in the best long-term interest of both our current and future policyholders as well as our shareholders. We announced in June 2008 that we would not be proceeding with a reattribution of the inherited estate

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- M&G had a very strong year in 2008 posting record gross fund inflows of £16.2 billion, an increase of 10 per cent on 2007
- Net inflows of £3.4 billion compared with net outflows of €334 billion across the European asset management industry and £2.1 billion net outflows from UK asset managers across retail and institutional funds
- Over the three years to December 2008, 35 per cent of M&G's retail funds delivered top-quartile investment performance

Group Chief Executive's report
continued

2009 Priorities

Group

- Balancing growth with cash and capital generation
- Effectively manage the Group's risk profile
- Deliver growing dividend, determined after taking into account the Group's financial flexibility and opportunities to invest in areas of business offering attractive returns
- Targeting 2 times cover over time

Asia

- Expand the agency force and continue to improve productivity
- Maximise the potential from non-agency distribution and add new partners
- Further develop direct marketing channels and up-sell and cross-sell
- Increase focus on retirement services and health products

United States

- Capital conservation
- Continue to focus on improving efficiency of operation

United Kingdom

- Build on our strengths in the retirement income and savings market
- Strengthen our distribution capabilities
- Deliver improvement in operational performance and customer service whilst preserving our focus on costs
- Selectively participate in the wholesale market
- Make the most of our core capabilities and assets including our longevity experience, multi-asset investment expertise, brand, financial strength and large customer base

Asset management

- Maintain superior investment performance for both internal and external funds
- Extend third-party retail and institutional business

Investing for the future

Amid all the turmoil in the global markets, it is imperative that we continue to invest for the future to ensure we are positioned to accelerate out of the economic slowdown and maintain our record of outperformance.

Key to this will be our ability to prepare for, identify and capture emerging growth opportunities. With this in mind, in 2008 we continued to reinforce the already strong positions of our businesses in our chosen markets – and these efforts have continued into 2009, with a particular focus on recruiting the best talent.

Improving the efficiency of our operations remains an ongoing objective. As announced in our 2007 full-year results, the first phase of our UK cost reduction programme delivered savings of £115 million per annum. The agreement with Capita, which commenced in April 2008, will ultimately deliver a further £60 million per annum of savings and will enable our UK business to achieve its total cost savings target of £195 million by the end of 2010. In the US we are already a market leader in terms of operational efficiency and have service levels that are externally acknowledged as world class. We will continue to invest in maintaining and extending this leadership through further systems simplification, enabling us to stay ahead of the competition.

Outlook

It is clear that 2009 will be a challenging year. Indeed, there is an increasing likelihood that in some parts of the world recession will continue into 2010. However, the global economy will ultimately rebound – albeit at different times and different speeds in different markets.

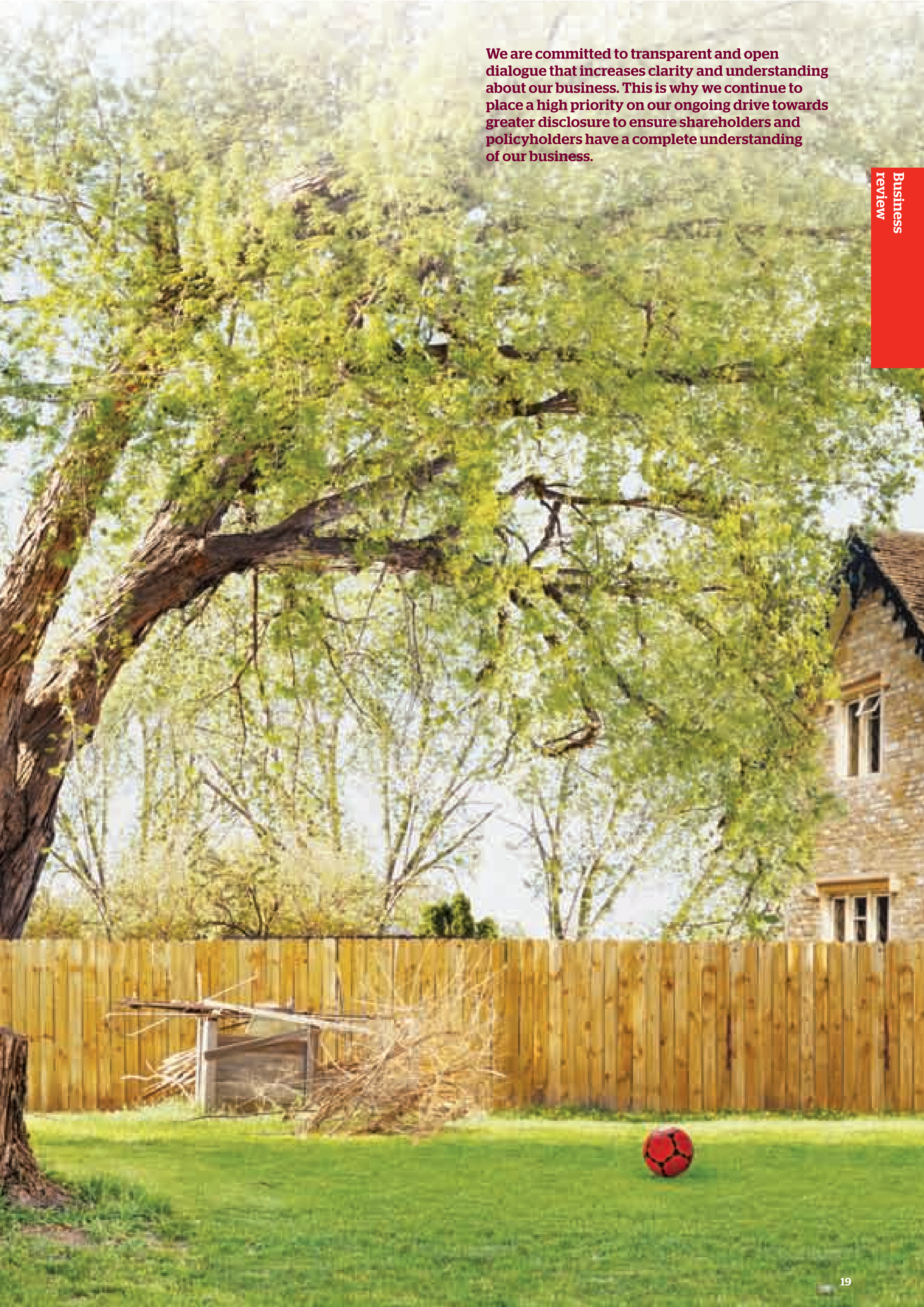
Given the uncertainty in the operating environment we have taken a prudent approach to our plans for 2009. This means focusing on balancing new business with cash generation, and making it our absolute priority to ensure that our balance sheet and capital position remain robust. At the same time, we will continue to position our businesses to take advantage of any improvement in market conditions.

It is my firm belief that this cautious but proactive strategy will allow us both to continue to outperform over the economic cycle.

Mark Tucker
Group Chief Executive

Business review

more: transparency



We are committed to transparent and open dialogue that increases clarity and understanding about our business. This is why we continue to place a high priority on our ongoing drive towards greater disclosure to ensure shareholders and policyholders have a complete understanding of our business.