Notes on the IFRS basis results continued

R: Debt securities of US insurance operations: valuation basis, accounting presentation of gains and losses and securities in an unrealised loss position

i Valuation basis

Under IAS 39, unless categorised as 'held to maturity' or 'loans and receivables' debt securities are required to be fair valued. Where available, quoted market prices are used. However, where securities do not have an externally quoted price based on regular trades or where markets for the securities are no longer active as a result of market conditions, IAS 39 requires that valuation techniques be applied. IFRS 7 requires classification of the fair values applied by the Group into a three-level hierarchy. At 30 June 2013, 0.1 per cent of Jackson's debt securities was classified as level 3 (30 June 2012: 0.1 per cent; 31 December 2012: 0.1 per cent) comprising of fair values where there are significant inputs which are not based on observable market data.

ii Accounting presentation of gains and losses

Except for certain assets covering liabilities that are measured at fair value, the debt securities of the US insurance operations are classified as 'available-for-sale'.

Unless impaired, fair value movements are recognised in other comprehensive income. Realised gains and losses, including impairments, recorded in the income statement are as shown in note F of this report.

iii Half year 2013 movements in unrealised gains and losses

In half year 2013 there was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £2,807 million to a net unrealised gain of £1,270 million as analysed in the table below. This decrease reflects the effects of rising long-term interest rates.

Available-for-sale securities	30 Jun 2013 £m	Changes in unrealised appreciation† (Reflected as part of movement in other comprehensive income)	Foreign exchange translation (Reflected as part of movement in other comprehensive income)	31 Dec 2012 £m
Assets fair valued at below book value:				
Book value*	10,595			4,551
Unrealised loss notes (iv)(a),(b)	(747)	(546)	(23)	(178)
Fair value (as included in statement of financial position)	9,848			4,373
Assets fair valued at or above book value:				
Book value*	21,348			25,467
Unrealised gain	2,017	(1,161)	193	2,985
Fair value (as included in statement of financial position)	23,365			28,452
Total:				
Book value*	31,943			30,018
Net unrealised gain (loss)	1,270	(1,707)	170	2,807
Fair value (as included in statement of financial position)‡	33,213			32,825

* Book value represents cost/amortised cost of the debt securities.
† Translated at the average rate of US$1.5439:£1.
‡ Debt securities for US operations included in the statement of financial position at 30 June 2013 and as referred to in note Q, comprise:

	2013 £m 30 Jun	2012 £m 30 Jun	2012 £m 31 Dec
Available-for-sale	33,213	27,055	32,825
Fair value through profit and loss:			
Securities of consolidated investment funds	–	6	–
Securities held to back liabilities for funds withheld under reinsurance arrangement	155	–	168
	33,368	27,061	32,993

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

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

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

	30 Jun 2013 £m		30 Jun 2012 £m		31 Dec 2012 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
Between 90% and 100%	7,510	(317)	1,160	(27)	4,214	(112)
Between 80% and 90%	2,214	(369)	190	(31)	85	(13)
Below 80%	124	(61)	163	(99)	74	(53)
Total	9,848	(747)	1,513	(157)	4,373	(178)

(b) Unrealised losses by maturity of security

	2013 £m	2012 £m	
	30 Jun	30 Jun	31 Dec
Less than 1 year	–	–	–
1 year to 5 years	(6)	(2)	(1)
5 years to 10 years	(215)	(18)	(9)
More than 10 years	(440)	(11)	(91)
Mortgage-backed and other debt securities	(86)	(126)	(77)
Total	(747)	(157)	(178)

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

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

	30 Jun 2013 £m			30 Jun 2012 £m			31 Dec 2012 £m		
	Non-investment grade	Investment grade	Total	Non-investment grade	Investment grade	Total	Non-investment grade	Investment grade	Total
Less than 6 months	(16)	(326)	(342)	(7)	(15)	(22)	(5)	(101)	(106)
6 months to 1 year	(1)	(345)	(346)	(4)	(6)	(10)	(1)	(1)	(2)
1 year to 2 years	(3)	–	(3)	(5)	(3)	(8)	(2)	–	(2)
2 years to 3 years	(2)	–	(2)	(3)	–	(3)	(1)	–	(1)
More than 3 years	(23)	(31)	(54)	(52)	(62)	(114)	(31)	(36)	(67)
Total	(45)	(702)	(747)	(71)	(86)	(157)	(40)	(138)	(178)

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

As shown in the table (a) above, £61 million of the £747 million of gross unrealised losses at 30 June 2013 (30 June 2012: £99 million of the £157 million; 31 December 2012: £53 million of the £178 million of gross unrealised losses) related to securities whose fair value was below 80 per cent of the book value. The analysis of the £61 million (30 June 2012: £99 million; 31 December 2012: £53 million), by category of debt securities and by age analysis indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

	30 Jun 2013 £m		30 Jun 2012 £m		31 Dec 2012 £m	
Category analysis	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
Residential mortgage-backed securities:						
Prime (including agency)	5	(2)	27	(10)	5	(2)
Alt-A	–	–	11	(3)	–	–
Sub-prime	7	(2)	51	(22)	18	(8)
	12	(4)	89	(35)	23	(10)
Commercial mortgage-backed securities	13	(21)	8	(29)	10	(23)
Other asset-backed securities	24	(13)	53	(31)	41	(20)
Total structured securities	49	(38)	150	(95)	74	(53)
Corporates	75	(23)	13	(4)	–	–
Total	124	(61)	163	(99)	74	(53)

Notes on the IFRS basis results continued

R: Debt securities of US insurance operations: valuation basis, accounting presentation of gains and losses and securities in an unrealised loss position continued

The following table shows the age analysis as at 30 June 2013, of the securities whose fair value were below 80 per cent of the book value:

	30 Jun 2013 £m		30 Jun 2012 £m		31 Dec 2012 £m	
Age analysis	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
Less than 3 months	79	(25)	32	(10)	7	(2)
3 months to 6 months	2	(1)	–	–	–	–
More than 6 months	43	(35)	131	(89)	67	(51)
	124	(61)	163	(99)	74	(53)

S: Net core structural borrowings of shareholder-financed operations

	2013 £m	2012 £m	
	30 Jun	30 Jun	31 Dec
Core structural borrowings of shareholder-financed operations: note (i)			
Perpetual subordinated capital securities (Innovative Tier 1) notes (ii), (vi)	2,327	1,808	1,746
Subordinated notes (Lower Tier 2) note (ii)	834	830	831
Subordinated debt total	3,161	2,638	2,577
Senior debt: note (iii)			
2023	300	300	300
2029	249	249	249
Holding company total	3,710	3,187	3,126
PruCap bank loan note (iv)	275	250	275
Jackson surplus notes (Lower Tier 2) note (ii)	164	159	153
Total (per condensed consolidated statement of financial position)	4,149	3,596	3,554
Less: Holding company cash and short-term investments (recorded within the condensed consolidated statement of financial position) note (v)	(1,490)	(1,222)	(1,380)
Net core structural borrowings of shareholder-financed operations	2,659	2,374	2,174

Notes

(i) The maturity profile, currency and interest rates applicable to the core structural borrowings of shareholder-financed operations of the Group are as detailed in note H13 of the Group's consolidated financial statements for the year ended 31 December 2012. Other than the changes described in notes (iv) and (vi) below, there are no further changes affecting these core structural borrowings in half year 2013.

(ii) These debt classifications are consistent with the treatment of capital for regulatory purposes, as defined in the Prudential Regulation Authority handbook.
The Group has designated US$3.55 billion (30 June 2012 and 31 December 2012: US$2.85 billion) of its Tier 1 subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.

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

(iv) The PruCap bank loan of £275 million has been made in two tranches: a £160 million loan maturing in June 2014, currently drawn at a cost of 12 month £LIBOR plus 0.6 per cent and a £115 million loan maturing on 20 December 2017 and currently drawn at a cost of 12 month £LIBOR plus 0.79 per cent.

(v) Including central finance subsidiaries.

(vi) In January 2013, the Company issued core structural borrowings of US$700 million 5.25 per cent Tier 1 perpetual subordinated capital securities primarily to Asian retail investors. The proceeds, net of costs, were US$689 million.