Notes on the IFRS basis results continued

M: Goodwill attributable to shareholders

	2013 £m	2012 £m	
	Half year	Half year	Full year
Cost			
At beginning of period	**1,589**	1,585	1,585
Additional consideration paid on previously acquired business	–	–	2
Exchange differences	**5**	2	2
At end of period	**1,594**	1,587	1,589
Aggregate impairment	**(120)**	(120)	(120)
Net book amount at end of period	**1,474**	1,467	1,469

The amounts shown above at 30 June 2013 and for 2012 include £1,153 million in respect of the purchase of M&G in 1999.

Goodwill, other than for M&G, of £321 million at 30 June 2013 (30 June 2012: £314 million; 31 December 2012: £316 million) represents amounts allocated to entities in Asia and the US operations in respect of acquisitions made prior to 2012. There was no goodwill attached to the purchase of REALIC and Thanachart Life as discussed in note X. Other goodwill amounts by acquired operations are not individually material.

N: Deferred acquisition costs and other intangible assets attributable to shareholders

Except for acquisition costs of with-profits contracts of the UK regulated with-profits funds, which are accounted for under the realistic Prudential Regulation Authority (PRA) regime, costs of acquiring new insurance business are accounted for with deferral and amortisation against margins in future revenues on the related insurance policies. Costs of acquiring new insurance business, principally commissions, marketing and advertising and certain other costs associated with policy insurance and underwriting that are not reimbursed by policy charges, are specifically identified and capitalised as part of deferred acquisition costs (DAC). In general, this deferral is presentationally shown by an explicit carrying value for DAC in the balance sheet. However, in some Asia operations the deferral is implicit through the reserving methodology. The recoverability of the explicitly and implicitly deferred acquisition costs is measured, and the capitalised costs are deemed impaired if the projected margins are less than the carrying value. To the extent that the future margins differ from those anticipated, then an adjustment to the carrying value will be necessary.

For UK regulated with-profits funds where the realistic PRA regime is applied, the basis of setting liabilities is such that it would be inappropriate for acquisition costs to be deferred, therefore these costs are expensed as incurred. The majority of the UK shareholder-backed business is individual and Group annuity business where the incidence of acquisition costs is negligible.

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

	2013 £m	2012* £m	
	30 Jun	30 Jun	31 Dec
Deferred acquisition costs related to insurance contracts as classified under IFRS 4	**4,851**	3,824	3,776
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4	**97**	103	100
	4,948	3,927	3,876
Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF)	**85**	62	64
Other intangibles	**505**	248	237
	590	310	301
Total of deferred acquisition costs and other intangible assets	**5,538**	4,237	4,177

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

	2013 £m						2012* £m	
	Deferred acquisition costs				PVIF and other intan-gibles†	Total 30 Jun	Total 30 Jun	Total 31 Dec
	UK	US note (i)	Asia	Asset manage-ment				
Balance at beginning of period:								
As previously reported	103	3,199	654	10	301	4,267	4,234	4,234
Effect of change in accounting policy[note B]	–	–	(90)	–	–	(90)	(90)	(90)
After effect of change	103	3,199	564	10	301	4,177	4,144	4,144
Additions[note (ii)]	1	372	92	4	288	757	535	1,059
Acquisition of subsidiaries[note (ii)]	–	–	–	–	21	21	–	5
Amortisation to the income statement:								
Operating profit	(8)	(199)	(83)	(2)	(19)	(311)	(308)	(682)
Non-operating profit	–	242	–	–	(3)	239	80	76
	(8)	43	(83)	(2)	(22)	(72)	(228)	(606)
Exchange differences	–	244	18	–	2	264	(33)	(155)
Change in amortisation of DAC related to net unrealised valuation movement on Jackson's available-for-sale securities recognised as Other Comprehensive Income	–	419	–	–	–	419	(181)	(270)
Reclassification of Japan Life as held for sale	–	–	(28)	–	–	(28)	–	–
Balance at end of period	96	4,277	563	12	590	5,538	4,237	4,177

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

† PVIF and Other intangibles includes software rights of £62 million at 30 June 2013 (31 December 2012: £60 million) with additions of £11 million, amortisation of £10 million and exchange gains of £1 million.

Notes

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

	2013 £m	2012 £m	
	30 Jun	30 Jun	31 Dec
Variable annuity business	3,917	3,287	3,330
Other business	953	794	821
Cumulative shadow DAC (for unrealised gains/losses booked in other comprehensive income)	(593)	(896)	(952)
Total DAC for US operations	4,277	3,185	3,199

(ii) The additions of £288 million for PVIF and other intangibles in half year 2013 include the amount advanced to secure the exclusive 15-year bancassurance partnership agreement entered with Thanachart Bank in Thailand.

The additions of £21 million for acquisitions of subsidiaries for PVIF and other intangibles in half year 2013 is for the acquisition of Thanachart Life. The amount of £5 million for the full year 2012 was for the acquisition of REALIC.

See note X for further details.

Notes on the IFRS basis results continued

N: Deferred acquisition costs and other intangible assets attributable to shareholders continued

Overview of the deferral and amortisation of acquisition costs for Jackson

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

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

The Company adopted the US Financial Accounting Standards Board requirements in the Emerging Issues Task Force EITF Update No 2010-26 on 'Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts' from 1 January 2012 into Prudential's Group IFRS reporting for the results of Jackson and those Asia operations whose IFRS insurance assets and liabilities are measured principally by reference to US GAAP principles. Under the Update insurers are required to capitalise only those incremental costs directly relating to successfully acquiring a contract from 1 January 2012. For Group IFRS reporting the Company chose to apply this new basis retrospectively for the results of these operations.

Mean reversion technique

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

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

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

Sensitivity of amortisation charge

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

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

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

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

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

In half year 2013, the DAC amortisation charge for operating profit was determined after including a credit for decelerated amortisation of £20 million (half year 2012: £25 million; full year 2012: £56 million). The half year 2013 amount primarily reflects the separate account performance of 5 per cent, net of all fees, over the assumed level for the period.

The application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation while the mean reversion assumption lies within the corridor. It would take a very significant movement in equity markets in 2013 (outside the range of negative 25 per cent to positive 50 per cent) for the mean reversion assumption to move outside the corridor.