Notes on the IFRS basis results continued

C: Segment disclosure – profit before tax

	Note	2013 £m	2012* £m	
		Half year	Half year	Full year
Asia operations				
Insurance operations:†	E(i)			
Operating results before gain on sale of stake in China Life of Taiwan		476	406	862
Gain on sale of stake in China Life of Taiwan		–	–	51
Total Asia insurance operations before development expenses		476	406	913
Development expenses		(2)	(3)	(7)
Total Asia insurance operations after development expenses		474	403	906
Eastspring Investments		38	32	69
Total Asia operations		512	435	975
US operations				
Jackson (US insurance operations)	E(ii)	582	442	964
Broker-dealer and asset management		34	17	39
Total US operations		616	459	1,003
UK operations				
UK insurance operations:				
Long-term business	E(iii)	341	336	703
General insurance commission note (i)		15	17	33
Total UK insurance operations		356	353	736
M&G (including Prudential Capital)		225	199	371
Total UK operations		581	552	1,107
Total segment profit		1,709	1,446	3,085
Other income and expenditure				
Investment return and other income		10	5	13
Interest payable on core structural borrowings		(152)	(140)	(280)
Corporate expenditure	G	(128)	(120)	(231)
Total		(270)	(255)	(498)
Solvency II implementation costs		(13)	(27)	(48)
Restructuring costs note (ii)		(11)	(7)	(19)
Operating profit based on longer-term investment returns		1,415	1,157	2,520
Short-term fluctuations in investment returns on shareholder-backed business†	F	(755)	(47)	187
Amortisation of acquisition accounting adjustments		(30)	–	(19)
Gain on dilution of Group holdings note (iii)		–	42	42
(Loss) profit attaching to held for sale Japan Life business†	AB	(124)	14	17
Profit before tax attributable to shareholders		506	1,166	2,747

	Note	2013	2012*	
		Half year	Half year	Full year
Basic EPS based on operating profit based on longer-term investment returns after tax and non-controlling interests†	I	42.2p	34.6p	76.9p
Basic EPS based on total profit after tax and non-controlling interests	I	14.3p	35.0p	85.1p

* The 2012 comparative results have been adjusted from those previously published for the retrospective application of the new and amended accounting standards described in note B.

† To facilitate comparisons of operating profit based on longer-term investment returns that reflect the Group's retained operations, the results attributable to the held for sale Japan Life business are included separately within the supplementary analysis of profit above.

Notes

(i) UK operations transferred its general insurance business to Churchill Insurance in 2002. General insurance commission represents the commission receivable net of expenses for Prudential-branded general insurance products as part of this arrangement.

(ii) Restructuring costs are incurred in the UK and represent one-off expenses incurred in securing expense savings.

(iii) During 2012, M&G reduced its holdings in PPM South Africa resulting in a reclassification from a subsidiary to an associate giving rise to a gain on dilution of £42 million.

Determining operating segments and performance measure of operating segments

Operating segments

The Group's operating segments, determined in accordance with IFRS 8, 'Operating Segments', are as follows:

Insurance operations:
- Asia
- US (Jackson)
- UK

Asset management operations:
- M&G (including Prudential Capital)
- Eastspring Investments
- US broker-dealer and asset management (including Curian)

The Group's operating segments are also its reportable segments for the purposes of internal management reporting with the exception of Prudential Capital (PruCap) which has been incorporated into the M&G operating segment for the purposes of segment reporting.

Performance measure

The performance measure of operating segments utilised by the Company is IFRS operating profit attributable to shareholders based on longer-term investment returns. This measure excludes the recurrent items of short-term fluctuations in investment returns, the amortisation of the acquisition accounting adjustments arising on the purchase of businesses and for 2012, the gain arising upon the dilution of the Group's holding in PPM South Africa. As explained further in note AB, in July 2013, the Group announced that it has agreed to sell its Japan Life business to SBI Holdings, Inc. As the sale of the business was highly probable at 30 June 2013, the Japan Life business has been classified as 'held for sale' in these condensed consolidated financial statements. In order to facilitate comparisons of operating profit based on longer-term investment returns that reflect the Group's retained operations, the remeasurement of the held for sale Japan Life business at 30 June 2013 to fair value less costs to sell, together with the half year 2013 results of this business and those for the 2012 comparatives are shown separately within the supplementary analysis of profit. Operating earnings per share is calculated on operating profit based on longer-term investment returns, after tax and non-controlling interests.

Segment results that are reported to the Group Executive Committee include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and the Asia Regional Head Office.

Except in the case of the assets backing the UK annuity business, unit-linked and US variable annuity separate account liabilities, operating profit based on longer-term investment returns for shareholder-financed business is determined on the basis of expected longer-term investment returns. In the case of assets backing the UK annuity business, unit-linked and US variable annuity separate account liabilities, the basis of determining operating profit based on longer-term investment returns is as follows:

- Assets backing UK annuity business liabilities. For UK annuity business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value and associated policyholder liability movements are recorded within the operating results based on longer-term investment returns. Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.
- Assets backing unit-linked and US variable annuity business separate account liabilities. For such business, the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly, the operating results based on longer-term investment returns reflect the current period value movements in unit liabilities and the backing assets.

In the case of other shareholder-financed business, the measurement of operating profit based on longer-term investment returns reflects the particular features of long-term insurance business where assets and liabilities are held for the long term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance of life businesses exclusive of the effects of short-term fluctuations in market conditions.

In determining the profit on this basis, the following key elements are applied to the results of the Group's shareholder-financed operations.

(a) Debt, equity-type securities and loans

Longer-term investment returns for both debt, equity-type securities and loans comprise longer-term actual income receivable for the period (interest/dividend income) and longer-term capital returns.

In principle, for debt securities and loans, the longer-term capital returns comprise two elements. The first element is a risk margin reserve (RMR) based charge for the expected level of defaults for the period, which is determined by reference to the credit quality of the portfolio. The difference between impairment losses in the reporting period and the RMR charge to the operating result is reflected in short-term fluctuations in investment returns. The second element is for the amortisation of interest-related realised gains and losses to operating results based on longer-term investment returns to the date when sold bonds would have otherwise matured.

Notes on the IFRS basis results continued

C: Segment disclosure – profit before tax continued

Jackson is the shareholder-backed operation for which the distinction between impairment losses and interest-related realised gains and losses is in practice relevant to a significant extent. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) developed by external third parties such as PIMCO or BlackRock Solutions to determine the average annual RMR to apply to debt securities held to back general account business. Debt securities held to back separate account and reinsurance funds withheld are not subject to an RMR charge. Further details of the RMR charge, as well as the amortisation of interest-related realised gains and losses, for Jackson are shown in note F(iii).

For debt securities backing non-linked shareholder-financed business of the UK insurance operations (other than the annuity business) and of the Asia insurance operations, the realised gains and losses are principally interest related. Accordingly, all realised gains and losses to date for these operations are being amortised over the period to the date those securities would otherwise have matured, with no explicit RMR charge.

At 30 June 2013, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £522 million (30 June 2012: £441 million; 31 December 2012: £495 million).

For equity-type securities, the longer-term rates of return are estimates of the long-term trend investment return for income and capital having regard to past performance, current trends and future expectations. Equity-type securities held for shareholder-financed operations other than the UK annuity business, unit-linked and US variable annuity are of significance for the US and Asia insurance operations. Different rates apply to different categories of equity-type securities.

As at 30 June 2013, the equity-type securities for US insurance non-separate account operations amounted to £1,188 million (30 June 2012: £1,017 million; 31 December 2012: £1,004 million). For these operations, the longer-term rates of return for income and capital applied in half year 2013 are as follows:

	2013	2012	
	Half year	Half year	Full year
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	5.7% to 6.5%	5.6% to 6.2%	5.5% to 6.2%
Other equity-type securities such as investments in limited partnerships and private equity funds	7.7% to 8.5%	7.6% to 8.2%	7.5% to 8.2%

For Asia insurance operations, excluding assets of the Japan Life held for sale business, investments in equity securities held for non-linked shareholder-financed operations amounted to £526 million as at 30 June 2013 (30 June 2012: £574 million; 31 December 2012: £474 million). The rates of return applied in the periods 2013 and 2012 for these investments ranged from 1.3 per cent to 13.8 per cent with the rates applied varying by territory.

The longer-term rates of return discussed above for equity-type securities are determined after consideration by the Group's in-house economists of long-term expected real government bond returns, equity risk premium and long-term inflation. These rates are broadly stable from period to period but may be different between countries, reflecting, for example, differing expectations of inflation in each territory. The assumptions are for returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

The longer-term investment returns for the Asia insurance joint ventures accounted for on the equity method are determined on a similar basis as the other Asia insurance operations described above.

(b) US variable and fixed index annuity business

The following value movements for Jackson's variable and fixed index annuity business are excluded from operating profit based on longer-term investment returns:

- Fair value movements for equity-based derivatives;
- Fair value movements for embedded derivatives for Guaranteed Minimum Withdrawal Benefit (GMWB) 'not for life' and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance (see note below);
- Movements in accounts carrying value of Guaranteed Minimum Death Benefit (GMDB) and GMWB 'for life' liabilities, for which, under the 'grandfathered' US GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements;
- Fee assessments and claim payments, in respect of guarantee liabilities; and
- Related changes to amortisation of deferred acquisition costs for each of the above items.

Note: US operations – Embedded derivatives for variable annuity guarantee features

The GMIB liability, which is fully reinsured, subject to a deductible and annual claim limits, is accounted for in accordance with FASB ASC Subtopic 944-80 Financial Services – Insurance – Separate Accounts (formerly SOP 03-1) under IFRS using 'grandfathered' US GAAP. As the corresponding reinsurance asset is net settled, it is considered to be a derivative under IAS 39, 'Financial Instruments: Recognition and Measurement', and the asset is therefore recognised at fair value. As the GMIB benefit is economically reinsured the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

(c) Other derivative value movements

Generally, derivative value movements are excluded from operating results based on longer-term investment returns (unless those derivative value movements broadly offset changes in the accounting value of other assets and liabilities included in operating profit). The principal example of non-equity based derivatives (for example interest rate swaps and swaptions) whose value movements are excluded from operating profit arises in Jackson. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson's bond portfolio (for which value movements are booked in the statement of comprehensive income rather than the income statement), product liabilities (for which US GAAP accounting as 'grandfathered' under IFRS 4 does not fully reflect the economic features being hedged), and the interest rate exposure attaching to equity-based embedded derivatives.

(d) Other liabilities to policyholders and embedded derivatives for product guarantees

Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between territories depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities is broadly equivalent in the income statement, and operating profit based on longer-term investments returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (ie after allocated investment return and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

Asia – Hong Kong

For certain non-participating business, the economic features are more akin to asset management products with policyholder liabilities reflecting asset shares over the contract term. For these products, the charge for policyholder benefits in the operating results should reflect the asset share feature rather than volatile movements that would otherwise be reflected if the local regulatory basis (which is applied for IFRS balance sheet purposes) was used.

For other Hong Kong non-participating business, longer-term interest rates are used to determine the movement in policyholder liabilities for determining operating results. Similar principles apply for other Asia operations.

UK shareholder-backed annuity business

The operating result based on longer-term investment returns reflects the impact of value movements on policyholder liabilities for annuity business in Prudential Retirement Income Limited (PRIL) and The Prudential Assurance Company Limited (PAC) non-profit sub-fund after adjustments to allocate the following elements of the movement to the category of 'short-term fluctuations in investment returns' in the Group's supplementary analysis of profit:

- The impact on credit risk provisioning of actual upgrades and downgrades during the period;
- Credit experience compared to assumptions; and
- Short-term value movements on assets backing the capital of the business.

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Negative experience compared to assumptions is included within short-term fluctuations in investment returns without further adjustment. This is to be contrasted with positive experience where surpluses are retained in short-term allowances for credit risk for IFRS reporting purposes. The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

(e) Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply. For these businesses it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include realised gains and losses (including impairments) in the operating result with unrealised gains and losses being included in short-term fluctuations in investment returns. For this purpose impairments are calculated as the credit loss determined by comparing the projected cash flows discounted at the original effective interest rate to the carrying value. In some instances it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying economic substance of the arrangements.

(f) Amortisation of acquisition accounting adjustments

The amortisation of acquisition accounting adjustments comprises principally the charge for the adjustments arising on the purchase of REALIC in 2012.

Notes on the IFRS basis results continued

C: Segment disclosure – profit before tax continued

Additional segmental analysis of revenue

The additional segmental analyses of revenue from external customers excluding investment return and net of outward reinsurance premiums are as follows:

	Half year 2013 £m				
	Asia	US	UK	Intra-group	Total
Revenue from external customers:					
Insurance operations	4,276	7,858	2,786	–	14,920
Asset management	122	421	562	(172)	933
Unallocated corporate	–	–	10	–	10
Intra-group revenue eliminated on consolidation	(49)	(43)	(80)	172	–
Total revenue from external customers	4,349	8,236	3,278	–	15,863

	Half year 2012* £m				
	Asia	US	UK	Intra-group	Total
Revenue from external customers:					
Insurance operations	3,419	7,063	3,374	–	13,856
Asset management	111	357	462	(154)	776
Unallocated corporate	–	–	10	–	10
Intra-group revenue eliminated on consolidation	(42)	(36)	(76)	154	–
Total revenue from external customers	3,488	7,384	3,770	–	14,642

	Full year 2012* £m				
	Asia	US	UK	Intra-group	Total
Revenue from external customers:					
Insurance operations	7,339	14,465	7,098	–	28,902
Asset management	222	725	972	(333)	1,586
Unallocated corporate	–	–	19	–	19
Intra-group revenue eliminated on consolidation	(84)	(77)	(172)	333	–
Total revenue from external customers	7,477	15,113	7,917	–	30,507

Revenue from external customers is made up of the following:

	2013 £m	2012* £m	
	Half year	Half year	Full year
Earned premiums, net of reinsurance	14,763	13,703	28,622
Fee income from investment contract business and asset management (presented as 'Other income')	1,100	939	1,885
Total revenue from external customers	15,863	14,642	30,507

* The 2012 comparative results have been adjusted retrospectively from those previously published for the application of the new accounting standards described in note B.

In their capacity as fund managers to fellow Prudential Group subsidiaries, M&G, Eastspring Investments and the US asset management businesses generate fees for investment management and related services. These services are charged at appropriate arm's length prices, typically priced as a percentage of funds under management. Intra-group fees included within asset management revenue were earned by the following asset management segment:

	2013 £m	2012* £m	
	Half year	Half year	Full year
Intra-group revenue generated by:			
M&G	80	76	172
Eastspring Investments	49	42	84
US broker-dealer and asset management (including Curian)	43	36	77
Total intra-group fees included within asset management segment	172	154	333

* The 2012 comparative results have been adjusted retrospectively from those previously published for the application of the new accounting standards described in note B.

Revenue from external customers of Asia, US and UK insurance operations shown above are net of outwards reinsurance premiums of £96 million, £172 million and £92 million respectively (half year 2012: £85 million, £38 million and £67 million respectively; full year 2012: £163 million, £193 million and £135 million respectively).

D: Profit before tax – asset management operations

The profit included in the income statement in respect of asset management operations for the period is as follows:

	2013 £m				2012* £m	
	M&G	US	Eastspring Investments	Half year Total	Half year Total	Full year Total
Revenue (excluding NPH broker-dealer fees)	612	181	123	916	831	1,739
NPH broker-dealer fees note (i)	–	249	–	249	215	435
Gross revenue	612	430	123	1,165	1,046	2,174
Charges (excluding NPH broker-dealer fees)	(401)	(147)	(96)	(644)	(513)	(1,144)
NPH broker-dealer fees note (i)	–	(249)	–	(249)	(215)	(435)
Gross charges	(401)	(396)	(96)	(893)	(728)	(1,579)
Share of profit from joint ventures and associates, net of related tax	5	–	11	16	14	24
Profit before tax	216	34	38	288	332	619
Comprising:						
Operating profit based on longer-term investment returns note (ii)	225	34	38	297	248	479
Short-term fluctuations in investment returns note (iii)	(9)	–	–	(9)	42	98
Gain on dilution of Group holdings	–	–	–	–	42	42
Profit before tax	216	34	38	288	332	619

* The 2012 comparative results have been adjusted retrospectively from those previously published for the application of the new and amended accounting standards described in note B. One of the new accounting standards adopted was IFRS 11 which requires joint ventures to be equity accounted. Accordingly, share of profit from joint ventures and associates is disclosed as a separate line.

Notes

(i) Under IFRS, disclosure details of segment revenue are required. The segment revenue of the Group's asset management operations is required to include NPH broker-dealer fees which represent commissions received, that are then paid on to the writing brokers on the sale of investment products. This item is for amounts which, reflecting their commercial nature, are also wholly reflected as charges within the income statement. After allowing for these charges, there is no effect on profit from this item.

The presentation in the table above shows the amounts attributable to this item so that the underlying revenue and charges can be seen.