DANAHER CORP /DE/
Form 424B2
June 14, 2011
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The information in this preliminary prospectus supplement is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and we are not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)(2)
Registration No. 333-159060

Subject to Completion

Preliminary Prospectus Supplement Dated June 13, 2011

PROSPECTUS SUPPLEMENT

(To Prospectus dated May 8, 2009)

17,500,000 Shares

Common Stock

We are offering 17,500,000 shares of our common stock to be sold in this offering. We expect to receive approximately $ in aggregate gross proceeds plus up to approximately $ in additional aggregate gross proceeds if the underwriters option is exercised in full.

Our common stock is listed on the New York Stock Exchange under the symbol DHR. The last reported sale price of our common stock on June 10, 2011 was $51.47 per share.

Investing in our common stock involves risks. You should read this prospectus supplement and the accompanying prospectus carefully before you make your investment decision. See Risk Factors beginning on page S-10 of this prospectus supplement, as well as documents we file with the Securities and Exchange Commission that are incorporated by reference herein for more information.

	Per Share	Total
Public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to us	$	$

We have granted the underwriters the option to purchase within 30 days from the date of this prospectus supplement up to an additional 1,750,000 shares of common stock at the public offering price per share, less discounts and commissions.

The shares will be ready for delivery on or about , 2011.

Joint Book-Running Managers

Citi	**Morgan Stanley**
Barclays Capital	**UBS Investment Bank**

Co-Managers

Baird		**Jefferies**
Banca IMI	**Mitsubishi UFJ Securities**	**Wells Fargo Securities**

The date of this prospectus supplement is , 2011

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Prospectus Supplement

Prospectus

You should rely only on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus or any free writing prospectus we provide to you. We and the underwriters have not authorized anyone else to provide you with different or additional information. We are not making an offer of these shares of common stock in any jurisdiction where the offer is not permitted. You should not assume that the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus or any free writing prospectus is accurate as of any date other than the date on the front of that document.

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ABOUT THIS PROSPECTUS SUPPLEMENT

This document is in two parts. The first part is this prospectus supplement, which describes the specific terms of the offering of shares of common stock and other matters relating to us and our financial condition. The second part is the accompanying base prospectus, which gives more general information about securities we may offer from time to time, some of which does not apply to the shares of common stock we are offering. Generally, when we refer to the prospectus, we are referring to both parts of this document combined. If information in this prospectus supplement or any related free writing prospectus differs from information in the accompanying prospectus, you should rely on the information in this prospectus supplement or the related free writing prospectus.

Except as the context otherwise requires, or as otherwise specified or used in this prospectus supplement or the accompanying prospectus, the terms we, our, us, the Company, and Danaher refer to Danaher Corporation and its consolidated subsidiaries. References in this prospectus supplement to U.S. dollars, U.S. $ or $ are to the currency of the United States of America.

The distribution of this prospectus supplement and the accompanying prospectus and the offering of the shares of common stock in certain jurisdictions may be restricted by law. Persons who come into possession of this prospectus supplement, any related free writing prospectus and the accompanying prospectus should inform themselves about and observe any such restrictions. This prospectus supplement, any related free writing prospectus and the accompanying prospectus do not constitute, and may not be used in connection with, an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer or solicitation.

You should not consider any information in this prospectus supplement, any related free writing prospectus or the accompanying prospectus to be investment, legal or tax advice. You should consult your own counsel, accountant and other advisors for legal, tax, business, financial and related advice regarding the purchase of the shares of common stock. We are not making any representation to you regarding the legality of an investment in the common stock by you under applicable investment or similar laws.

You should read and consider all information contained or incorporated by reference in this prospectus supplement, any related free writing prospectus and the accompanying prospectus that we provide or make available to you before making your investment decision.

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FORWARD-LOOKING INFORMATION

Certain information and statements included or incorporated by reference in this prospectus supplement, any related free writing prospectus or the accompanying prospectus are forward-looking statements within the meaning of the federal securities laws. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including, without limitation, statements regarding: projections of revenue, expenses, profit, profit margins, tax rates, tax provisions, cash flows, pension and benefit obligations and funding requirements, our liquidity position or other financial measures; management s plans and strategies for future operations, including statements relating to anticipated operating performance, cost reductions, restructuring activities, new product and service developments, competitive strengths or market position, acquisitions and related synergies (including with respect to the pending acquisition of Beckman Coulter, Inc. (the Beckman Coulter Acquisition)), divestitures, securities offerings, stock repurchases and executive compensation; growth, declines and other trends in markets we sell into; the anticipated impact of adopting new accounting pronouncements; the anticipated outcome of outstanding claims, legal proceedings, tax audits and other contingent liabilities; foreign currency exchange rates and fluctuations in those rates; general economic conditions and the existence, length or timing of an economic recovery; assumptions underlying any of the foregoing; and any other statements that address events or developments that we intend or believe will or may occur in the future. Forward-looking statements may be characterized by terminology such as believe, anticipate, should, could, would, intend, plan, will, expects, estimates, project potential, forecast, positioned and similar references to future periods. These statements are based on assumptions and assessments made by our management in light of their experience and perceptions of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Forward-looking statements are not guarantees of future performance, and actual results, developments and business decisions may differ materially from those envisaged by such forward-looking statements. Accordingly, you should not place undue reliance on any such forward-looking statements. Important factors that could cause actual results to differ materially from those envisaged in the forward-looking statements include the following:

We may not complete the pending Beckman Coulter Acquisition in the time frame we anticipate or at all; the acquired business may underperform relative to our expectations, and the Beckman Coulter Acquisition may cause our financial results to differ from our own or the investment community s expectations; and we may not be able to achieve anticipated cost savings or other synergies.

We have not identified any specific use of the net proceeds of this offering in the event that the merger agreement in connection with the Beckman Coulter Acquisition is terminated.

Instability in the global economy and financial markets may adversely affect our operating results, financial condition and liquidity.

The restructuring actions that we have taken to reduce costs could have long-term adverse effects on our business.

Our growth could suffer if the markets into which we sell our products decline, do not grow as anticipated or experience cyclicality.

We face intense competition and if we are unable to compete effectively, we may face decreased demand, decreased market share or price reductions for our products.

Our growth depends in part on the timely development and commercialization, and customer acceptance, of new products and product enhancements based on technological innovation.

Any inability to consummate acquisitions at our historical rate and at appropriate prices could negatively impact our growth rate and stock price.

Our acquisition of businesses could negatively impact our profitability and return on invested capital.

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The indemnification provisions of acquisition agreements by which we have acquired companies may not fully protect us and may result in unexpected liabilities.

Divestitures could negatively impact our business, and contingent liabilities from businesses that we have sold could adversely affect our results of operations and financial condition.

We may be required to recognize impairment charges for our goodwill and other indefinite lived intangible assets.

Foreign currency exchange rates may adversely affect our results of operations and financial condition.

Our reputation, ability to do business and results of operations may be impaired by improper conduct by any of our employees, agents or business partners.

Changes in our tax rates or exposure to additional income tax liabilities could affect our profitability. In addition, audits by tax authorities could result in additional tax payments for prior periods.

If we do not or cannot adequately protect our intellectual property, or if third parties infringe our intellectual property rights, we may suffer competitive injury or expend significant resources enforcing our rights.

Third parties may claim that we are infringing or misappropriating their intellectual property rights and we could suffer significant litigation expenses, losses or licensing expenses or be prevented from selling products or services.

We are subject to a variety of litigation and similar proceedings in the course of our business that could adversely affect our results of operations and financial condition.

Our operations, products and services expose us to the risk of environmental, health and safety liabilities, costs and violations that could adversely affect our financial condition, results of operations and reputation.

Product defects and unanticipated use or inadequate disclosure with respect to our products could adversely affect our reputation and results of operations.

Our businesses are subject to extensive regulation; failure to comply with those regulations could adversely affect our financial condition, results of operations and reputation.

We have outstanding debt, and our debt will increase as a result of the Beckman Coulter Acquisition and if we incur additional debt and do not retire existing debt.

Our indebtedness may limit our operations and our use of our cash flow, and any failure to comply with the covenants that apply to our indebtedness could adversely affect our liquidity and financial condition.

Our defined benefit pension plans are subject to financial market risks that could adversely affect our results of operations and cash flows.

We may incur higher costs to produce our products if commodity prices rise.

If we cannot adjust the purchases required for our manufacturing activities to reflect changing market conditions or customer demand, our profitability may suffer. In addition, our reliance upon sole sources of supply for certain materials and components could cause production interruptions, delays and inefficiencies.

If we cannot adjust our manufacturing capacity to reflect the demand for our products, our profitability may suffer.

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Changes in governmental regulations may reduce demand for our products or increase our expenses.

We may be unable to adjust to changes in the healthcare industry, some of which could adversely affect our business.

Work stoppages, union and works council campaigns, labor disputes and other matters associated with our labor force could adversely impact our results of operations and cause us to incur incremental costs.

Adverse changes in our relationships with, or the financial condition, performance or purchasing patterns of, key distributors and other channel partners could adversely affect our results of operations.

International economic, political, legal and business factors could negatively affect our results of operations, cash flows and financial condition.

If we suffer loss to our facilities, distribution systems or information technology systems due to catastrophe, our operations could be seriously harmed.

We own a 50% interest in, but do not control, the Apex Tool Group joint venture, and as a result we may not be able to direct management of the joint venture in a manner that we believe is in Danaher s best interests.

See Part I Item 1A and Management s Discussion and Analysis of Financial Condition and Results of Operations Overview of the Company s 2010 Annual Report on Form 10-K and Risk Factors and Recent Developments in this prospectus supplement for a further discussion regarding some of the reasons that actual results, developments and business decisions may differ materially from the results contemplated by our forward-looking statements. Forward-looking statements speak only as of the date of the document in which they are made. We do not assume any obligation or intend to update or revise any forward-looking statement, whether as a result of new information, future events and developments or otherwise.

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WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, as amended (the Exchange Act). You may read and copy all or any portion of this information at the SEC s principal office in Washington, D.C., and copies of all or any part thereof may be obtained from the Public Reference Room of the SEC located at 100 F Street, N.E., Washington, D.C. 20549 after payment of fees prescribed by the SEC. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room.

The SEC also maintains a website that contains reports, proxy statements and other information about issuers, like Danaher, who file electronically with the SEC. The address of that site is www.sec.gov.

Our website address is www.danaher.com. This reference to our website is intended to be an inactive textual reference only. Our website and the information contained therein or connected thereto are not incorporated by reference into this prospectus supplement or the accompanying prospectus.

This prospectus supplement and the accompanying prospectus are part of a registration statement and do not contain all of the information included in the registration statement. Whenever a reference is made in this prospectus supplement or the accompanying prospectus to any contract or other document of Danaher, the reference may not be complete and you should refer to the exhibits that are a part of the registration statement for a copy of the contract or document.

The SEC allows us to incorporate by reference information into this prospectus supplement and the accompanying prospectus, which means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is deemed to be part of this prospectus supplement and the accompanying prospectus, except for any information that is superseded by subsequent incorporated documents or by information that is contained directly in the accompanying prospectus or this prospectus supplement. This prospectus supplement and the accompanying prospectus incorporate by reference the documents set forth below that Danaher has previously filed with the SEC and that are not delivered with this prospectus supplement or the accompanying prospectus. These documents contain important information about Danaher and its financial condition.

Danaher SEC Filings (File No. 1-08089)	Period
Annual Report on Form 10-K	Fiscal year ended December 31, 2010 (including information specifically incorporated by reference from our Definitive Proxy Statement on Schedule 14A filed with the SEC on April 4, 2011, but excluding portions included therein that have been superseded by our Current Report on Form 8-K filed with the SEC on April 21, 2011, as described below)
Quarterly Report on Form 10-Q	Quarterly period ended April 1, 2011
Current Reports on Form 8-K	February 7, February 10, April 21 (only with respect to Item 8.01, Exhibit 23.1 under Item 9.01 and Exhibit 99.1 Audited reclassified historical consolidated financial information for the fiscal years ended December 31, 2008, 2009 and 2010 under Item 9.01) and May 11, 2011

All documents filed by us pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act (in each case, other than those documents or the portions of those documents not deemed to be filed) between the date of this prospectus supplement and the accompanying prospectus and the termination of the offering shall also be deemed to be incorporated herein by reference. Any statement contained in any document incorporated or

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deemed to be incorporated by reference herein or in the accompanying prospectus shall be deemed to be modified or superseded for purposes of this prospectus supplement and the accompanying prospectus to the extent that a statement contained in this prospectus supplement and the accompanying prospectus or in any other subsequently filed document which also is or is deemed to be incorporated by reference in this prospectus supplement and the accompanying prospectus modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this prospectus supplement and the accompanying prospectus.

To obtain a copy of these filings at no cost, you may write or telephone us at the following address:

Danaher Corporation

2200 Pennsylvania Avenue, N.W., Suite 800W

Washington, D.C. 20037-1701

Attention: Investor Relations

(202) 828-0850

Exhibits to the filings will not be sent, however, unless those exhibits have specifically been incorporated by reference into such document.

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SUMMARY

The following summary highlights selected information contained elsewhere in this prospectus supplement, the accompanying prospectus and in the documents incorporated by reference in this prospectus supplement and the accompanying prospectus and may not contain all the information you will need in making your investment decision. You should read this entire prospectus supplement and the accompanying prospectus carefully, including the Risk Factors section contained in this prospectus supplement, the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2010 and our consolidated financial statements and the related notes and the other documents incorporated by reference herein.

Danaher Corporation

Overview

We design, manufacture and market professional, medical, industrial and commercial products and services, which are typically characterized by strong brand names, innovative technology and major market positions. Our research and development, manufacturing, sales, distribution, service and administrative facilities are located in more than 50 countries. Our business consists of five segments: Test & Measurement; Environmental; Life Sciences & Diagnostics; Dental; and Industrial Technologies.

We strive to create shareholder value through:

- delivering sales growth, excluding the impact of acquired businesses, in excess of the overall market growth for our products and services;
- upper quartile financial performance compared to our peer companies; and
- upper quartile cash flow generation from operations compared to our peer companies.

To accomplish these goals, we use a set of tools and processes, known as the Danaher Business System (DBS), which are designed to continuously improve business performance in the critical areas of quality, delivery, cost and innovation. Within the DBS framework, we pursue a number of ongoing strategic initiatives relating to idea generation, product development and commercialization, global sourcing of materials and services, manufacturing improvement and sales and marketing. To further these objectives we also acquire businesses that either strategically fit within our existing business portfolio or expand our portfolio into a new and attractive business area. Given the rapid pace of technological development and the specialized expertise typical of our served markets, acquisitions also provide us important access to new technologies and domain expertise. We believe there are many acquisition opportunities available within our target markets. The extent to which we make and effectively integrate appropriate acquisitions will affect our overall growth and operating results. We also continually assess the strategic fit of our existing businesses and may divest businesses that are deemed not to fit with our strategic plan or are not achieving the desired return on investment.

Our principal executive offices are located at 2200 Pennsylvania Avenue, N.W., Suite 800W, Washington, D.C. 20037-1701. Our telephone number is (202) 828-0850.

Recent Developments

Pending Acquisition of Beckman Coulter, Inc.

On February 6, 2011, Danaher, Djanet Acquisition Corp., a Delaware corporation and an indirect wholly-owned subsidiary of Danaher (Purchaser) and Beckman Coulter, Inc., a Delaware corporation (Beckman Coulter), entered into a definitive Agreement and Plan of Merger (the

Merger Agreement), pursuant to which

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Danaher, through Purchaser, commenced an offer (the Offer) to acquire all of the outstanding shares of Beckman Coulter s common stock, par value $0.10 per share (the Beckman Coulter Shares), for $83.50 per share in cash, without interest (the Offer Price) to be followed by a second step cash-out merger at the Offer Price. The Beckman Coulter Acquisition is expected to be completed in the first half of 2011. However, there can be no assurance that the Beckman Coulter Acquisition will be completed. See Risk Factors Risks Related to the Beckman Coulter Acquisition.

Danaher anticipates financing the Beckman Coulter Acquisition through a combination of available cash, proceeds from the issuance of commercial paper and other debt securities and proceeds from the sale of common stock offered hereby. Danaher also intends to enter into an additional credit facility in order to expand borrowing capacity under its commercial paper program. The Merger Agreement does not contain a financing condition. See Financing below.

Beckman Coulter develops, manufactures and markets products that simplify, automate and innovate complex biomedical testing. Its diagnostic systems are found in hospitals and other clinical settings around the world and produce information used by physicians to diagnose disease, make treatment decisions and monitor patients. Scientists use its life science research instruments to study complex biological problems including causes of disease and potential new therapies or drugs. Beckman Coulter had revenues of approximately $3.7 billion in 2010, and would become part of Danaher s Life Sciences & Diagnostics segment, joining Danaher s Leica, AB Sciex, Radiometer and Molecular Devices businesses.

Beckman Coulter has advised Danaher that the U.S. Food and Drug Administration (FDA) recently conducted inspections of five of the facilities operated by Beckman Coulter, all of which were completed as of June 3, 2011. Beckman Coulter has received Form 483 Inspectional Observations from the FDA (the 483 Observations) with respect to the completed inspections, has shared the 483 Observations with Danaher and has responded or is in process of responding to such 483 Observations. Beckman Coulter has advised that most of the 483 Observations relate to matters currently being addressed by Beckman Coulter in connection with its previously disclosed compliance and quality system improvement initiative.

Completion of the Offer is subject to several conditions, including (i) that a majority of the Beckman Coulter Shares outstanding (determined on a fully diluted basis) be validly tendered and not validly withdrawn prior to the expiration of the Offer; (ii) the receipt of required government approvals inside and outside the United States; (iii) the absence of a material adverse effect on Beckman Coulter and (iv) certain other customary conditions.

The Merger Agreement also provides that following consummation of the Offer and satisfaction of certain customary conditions, Purchaser will be merged with and into Beckman Coulter (the Merger), with Beckman Coulter surviving as a wholly-owned indirect subsidiary of Danaher. Upon completion of the Merger, each Beckman Coulter Share outstanding immediately prior to the effective time of the Merger (excluding those Beckman Coulter Shares that are held by (i) Danaher, Purchaser, Beckman Coulter or their respective subsidiaries and (ii) stockholders of Beckman Coulter who properly exercised their appraisal rights under the Delaware General Corporation Law) will be converted into the right to receive the Offer Price.

If Purchaser holds 90% or more of the outstanding Beckman Coulter Shares following the completion of the Offer, the parties will effect the Merger as a short-form merger without the need for approval by Beckman Coulter s stockholders. Otherwise, Beckman Coulter may hold a special stockholders meeting to obtain stockholder approval of the Merger. Subject to the terms of the Merger Agreement, applicable law and the number of authorized Beckman Coulter Shares available under Beckman Coulter s Certificate of Incorporation, Beckman Coulter has granted Purchaser an irrevocable option (the Top-Up Option), exercisable after completion of the Offer, to purchase additional Beckman Coulter Shares from Beckman Coulter as necessary so that Danaher, Purchaser or their subsidiaries own one Beckman Coulter Share more than 90% of the total Beckman Coulter Shares outstanding immediately after the issuance of the Beckman Coulter Shares upon exercise of the Top-Up Option (the Top-Up Shares) on a fully diluted basis. Purchaser will pay the Offer Price for each Top-Up Share acquired upon exercise of the Top-Up Option.

The Merger Agreement can be terminated by Danaher or Beckman Coulter under certain circumstances, and Beckman Coulter will be required to pay Danaher a termination fee of $165 million in connection with certain terminations.

A copy of the Merger Agreement is included as an exhibit to our Current Report on Form 8-K filed with the SEC on February 10, 2011, which is incorporated by reference into this prospectus supplement and the accompanying prospectus. The foregoing description of the Beckman Coulter Acquisition and the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to such exhibit. This offering is not conditioned upon the completion of the Beckman Coulter Acquisition.

Financing

We estimate that the total amount of funds needed to purchase all Beckman Coulter Shares pursuant to the Offer, pay the merger consideration in connection with the subsequent merger of Purchaser into Beckman Coulter, retire Beckman Coulter s outstanding convertible notes and pay related fees, expenses and other amounts expected to become due and payable by Purchaser as a result of the Offer and the Merger will be approximately $6.7 billion (the Purchaser Obligations). In addition, as a result of the Offer and the subsequent Merger, Danaher will assume approximately $800 million of indebtedness and acquire approximately $450 million of cash, net of the fees, expenses and other amounts expected to become due and payable by Beckman Coulter as a result of the Offer and the Merger.

Danaher expects to fund the Purchaser Obligations through (1) approximately $3.3 billion of cash on hand, including the anticipated net proceeds from this offering, (2) approximately $1.8 billion of net proceeds from the sale of senior unsecured notes that Danaher expects to issue prior to the closing of the Offer, and (3) approximately $1.6 billion of net proceeds from the sale of notes that Danaher expects to issue immediately prior to the closing of the Offer under its U.S. commercial paper program. Immediately prior to issuing such commercial paper, Danaher expects to enter into a 364-day revolving credit facility with a borrowing capacity of up to $2.2 billion (the Bridge Facility) which, together with Danaher s existing $1.45 billion multi-year revolving credit facility (the Existing Facility), will provide credit support for the issuance of up to $3.65 billion of commercial paper under Danaher s U.S. commercial paper program. In the event that Danaher is unable to issue commercial paper or senior unsecured notes in the required amount, Danaher intends to finance any shortfall with borrowings under the Bridge Facility and/or the Existing Facility.

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The Offering

Common stock offered by us	17,500,000 shares (19,250,000 shares if the underwriters option is exercised in full)
Common stock to be outstanding after the offering	682,966,060 shares (684,716,060 shares if the underwriters option is exercised in full)
Use of proceeds	We anticipate that we will use the net proceeds from this offering to pay a portion of the purchase price of the Beckman Coulter Acquisition and for general corporate purposes if any proceeds remain or if the Beckman Coulter Acquisition does not close. See Use of Proceeds.
Risk factors	See Risk Factors beginning on page S-10 of this prospectus supplement and the documents incorporated by reference in the accompanying prospectus, for a discussion of risks you should carefully consider before deciding to invest in our common stock.
New York Stock Exchange symbol	DHR

The common stock to be outstanding after the offering is based on 665,466,060 shares outstanding as of May 31, 2011, and excludes shares issuable upon exercise of outstanding options, outstanding restricted stock units, common stock reserved for issuance under the Danaher Corporation 2007 Stock Incentive Plan, shares reserved for issuance under the Amended and Restated Danaher Corporation Executive Deferred Incentive Program, shares of common stock issuable upon conversion of our outstanding Liquid Yield Option Notes due 2021 and 1,750,000 shares subject to the exercise of the underwriters option. As of May 31, 2011, we had approximately 33,828,000 shares issuable upon exercise of outstanding stock options at a weighted average exercise price of $31.50 per share, approximately 5,347,000 outstanding restricted stock units, approximately 22,119,000 shares of common stock reserved for issuance under the Danaher Corporation 2007 Stock Incentive Plan, approximately 3,328,000 shares reserved for issuance under the Amended and Restated Danaher Corporation Executive Deferred Incentive Program and approximately 13,928,000 shares of common stock issuable upon conversion of our outstanding Liquid Yield Option Notes due 2021.

A description of our common stock is included in the accompanying prospectus under the caption Description of Capital Stock.

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RISK FACTORS

An investment in our common stock involves risks. You should carefully consider the risks and uncertainties described in this prospectus supplement and the accompanying prospectus, including the risk factors set forth in the documents and reports filed with the SEC that are incorporated by reference herein, such as the risk factors under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010 on file with the SEC, before you make an investment decision pursuant to this prospectus supplement and the accompanying prospectus. The risks and uncertainties we have described are not the only ones facing our Company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations.

Risks Related to the Beckman Coulter Acquisition

We may not complete the Beckman Coulter Acquisition within the time frame we anticipate or at all; the acquired business may underperform relative to our expectations, and the Beckman Coulter Acquisition may cause our financial results to differ from our own or the investment community s expectations; and we may not be able to achieve anticipated cost savings or other synergies.

The Beckman Coulter Acquisition is subject to a number of closing conditions, as described above, and the completion of the Beckman Coulter Acquisition is subject to a number of risks and uncertainties. The unpredictability of the business and regulatory conditions affecting the industries in which we and Beckman Coulter operate, the uncertainty of regulatory approvals, the requirement that a majority of the Beckman Coulter Shares outstanding (determined on a fully diluted basis) be validly tendered and not validly withdrawn prior to the expiration of the Offer and other risks and uncertainties may adversely affect our ability to complete the Beckman Coulter Acquisition within the time frame we anticipate or at all.

In addition, if the Beckman Coulter Acquisition is consummated, the acquired business may underperform relative to our expectations; it may cause our financial results to differ from our own or the investment community s expectations; and we may not be able to achieve anticipated cost savings or other synergies.

We have not identified any specific use of the net proceeds of this offering in the event that the Merger Agreement is terminated.

Consummation of the Beckman Coulter Acquisition is subject to a number of conditions, and, if the Merger Agreement is terminated for any reason, our board of directors and management will have broad discretion in the application of the net proceeds. Since the primary purpose of this offering is to provide funds for the Beckman Coulter Acquisition, we have not identified a specific use for the net proceeds in the event the Beckman Coulter Acquisition is not completed. If the Beckman Coulter Acquisition is not completed for any reason, we intend to use the net proceeds of this offering for general corporate purposes, which may include financing acquisitions, repayment of debt, capital expenditures, working capital, share repurchases or satisfaction of other obligations. The failure of our management to use the net proceeds from this offering effectively could have a material adverse effect on our business.

We have outstanding debt, and our debt will increase as a result of the Beckman Coulter Acquisition and if we incur additional debt and do not retire existing debt.

We have outstanding debt and other financial obligations and significant unused borrowing capacity. As of April 1, 2011, we had approximately $2.73 billion of debt on a consolidated basis. In addition, we had the ability to incur an additional $1.35 billion of debt under our outstanding credit facilities and commercial paper program. We may also obtain additional long-term debt and lines of credit to meet future financing needs, and anticipate

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issuing senior notes and commercial paper and assuming additional debt in connection with the Beckman Coulter Acquisition. See Summary Recent Developments Financing. Our debt level and related debt service obligations could have negative consequences, including:

- requiring us to dedicate significant cash flow from operations to the payment of principal and interest on our debt, which would reduce the funds we have available for other purposes, such as acquisitions and stock repurchases;
- reducing our flexibility in planning for or reacting to changes in our business and market conditions; and
- exposing us to interest rate risk since a portion of our debt obligations are at variable rates.

We may incur significantly more debt in the future. If we add new debt, the risks described above could increase.

Our current revolving credit facility imposes restrictions on us, including certain restrictions on our ability to incur liens on our assets, and requires us to maintain a consolidated leverage ratio (the ratio of consolidated indebtedness to consolidated indebtedness plus shareholders equity) as of the last day of any fiscal quarter of 0.65 to 1.0 or less. Our current revolving credit facility provides credit support for our commercial paper program; there are currently no amounts outstanding under this credit facility. The bridge facility we expect to enter into will also provide credit support for the issuance of additional amounts under our commercial paper program. See Summary Recent Developments Financing. Our long-term debt obligations include covenants that may adversely affect our ability to incur certain secured indebtedness or engage in certain types of sale and leaseback transactions. Our ability to comply with these restrictions and covenants may be affected by events beyond our control. If we breach any of these restrictions or covenants and do not obtain a waiver from the lenders, then, subject to applicable cure periods, our outstanding indebtedness could be declared immediately due and payable.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of the shares of common stock in this offering will be approximately $ (approximately $ if the underwriters exercise their option in full), after deducting the underwriters discounts and commissions and estimated offering expenses payable by us. We anticipate that we will use the net proceeds from this offering to pay a portion of the purchase price of the Beckman Coulter Acquisition and for general corporate purposes if any proceeds remain or if the Beckman Coulter Acquisition does not close. Pending any specific application, we may initially invest net proceeds in cash equivalents and short-term marketable securities.

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MATERIAL U.S. FEDERAL TAX CONSIDERATIONS TO NON-U.S. HOLDERS

The following is a general discussion of the material U.S. federal income and estate tax considerations applicable to non-U.S. holders with respect to their purchase, ownership and disposition of shares of our common stock. This discussion is for general information only and is not tax advice. Accordingly, all prospective non-U.S. holders of our common stock should consult their own tax advisors with respect to the U.S. federal, state, local and non-U.S. tax consequences of the purchase, ownership (other than a partnership or an entity or an arrangement treated as a partnership for U.S. federal tax purposes) and disposition of our common stock. In general, a non-U.S. holder means a beneficial owner of our common stock who is not for U.S. federal income tax purposes:

- an individual who is a citizen or resident of the United States;
- a corporation (or any other entity treated as a corporation for U.S. federal income tax purposes) created or organized in the United States or under the laws of the United States or of any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income tax regardless of its source; or
- a trust (i) if a U.S. court is able to exercise primary supervision over the trust s administration and one or more U.S. persons have the authority to control all of the trust s substantial decisions or (ii) that has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person.

This discussion is based on current provisions of the U.S. Internal Revenue Code of 1986, as amended, existing and proposed U.S. Treasury Regulations promulgated thereunder, current administrative rulings and judicial decisions, in effect as of the date of this prospectus supplement, all of which are subject to change or to differing interpretation, possibly with retroactive effect. Any change to the foregoing authorities could alter the U.S. federal income and estate tax consequences to non-U.S. holders described in this prospectus supplement. We assume in this discussion that a non-U.S. holder holds shares of our common stock as a capital asset (generally property held for investment).

This discussion does not address all aspects of U.S. federal income and estate taxation that may be relevant to a particular non-U.S. holder in light of that non-U.S. holder s individual circumstances nor does it address any U.S. federal gift or alternative minimum tax consequences or state, local or non-U.S. tax consequences of the purchase, ownership and disposition of our common stock. This discussion also does not consider any specific facts or circumstances that may apply to a non-U.S. holder and does not address the special tax rules applicable to particular non-U.S. holders, such as:

- insurance companies;
- tax-exempt organizations;
- banks and other financial institutions;
- brokers or dealers in securities or currencies or traders in securities that elect to use a mark-to-market method of accounting for their securities;
- partnerships or other pass-through entities and their members;

regulated investment companies or real estate investment trusts;

pension plans;

non-U.S. corporations that are classified as passive foreign investment companies or controlled foreign corporations for U.S. federal income tax purposes;

persons that hold our common stock as part of a straddle, hedge, conversion or constructive sale transaction, synthetic security or other integrated investment; or

certain former citizens or residents of the United States.

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If a partnership (or other entity treated as a partnership for U.S. federal income tax purposes) holds shares of our common stock, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. This discussion does not address the tax treatment of partnerships or persons who hold their common stock through partnerships for U.S. federal income tax purposes. A partner and the partnership holding shares of our common stock should consult his, her or its tax advisors regarding the tax considerations of acquiring, holding and disposing of shares of our common stock.

There can be no assurance that the Internal Revenue Service, referred to as the IRS, will not challenge one or more of the tax consequences described herein. We urge prospective investors to consult with their own tax advisors regarding the U.S. federal, state, local and non-U.S. income, estate and other tax considerations of acquiring, holding and disposing of shares of our common stock.

Distributions on Our Common Stock

Distributions on our common stock generally will constitute dividends for U.S. federal income tax purposes to the extent paid from our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. If a distribution exceeds our current and accumulated earnings and profits, the excess will be treated as a tax-free return of the non-U.S. holder s investment, up to such non-U.S. holder s tax basis in the common stock and thereafter as capital gain, subject to the tax treatment described below in Gain on Sale, Exchange or Other Taxable Disposition of Our Common Stock.

Dividends paid to a non-U.S. holder in respect of our common stock generally will be subject to U.S. federal withholding tax at a 30% rate, or such lower rate as may be specified by an applicable tax treaty. In order to claim the benefits of an applicable tax treaty, a non-U.S. holder will be required to satisfy applicable certification (for example, IRS Form W-8BEN or other applicable form) and other requirements prior to the distribution date. Non-U.S. holders eligible for a reduced rate of U.S. federal withholding tax under an applicable tax treaty may obtain a refund or credit of any amounts withheld in excess of that rate by filing an appropriate claim with the IRS. Non-U.S. holders should consult their own tax advisors regarding their entitlement to benefits under an applicable tax treaty and the requirements for claiming any such benefits.

Dividends paid to a non-U.S. holder that are effectively connected with its conduct of a trade or business within the United States (and, if required by an applicable tax treaty, are attributable to a permanent establishment or fixed base maintained by the non-U.S. holder in the United States) generally are exempt from the 30% U.S. federal withholding tax. Instead, the non-U.S. holder generally will be subject to U.S. federal income tax in respect of the dividend on a net income basis and at the graduated U.S. federal income tax rates applicable to U.S. persons. Non-U.S. holders will be required to comply with certification (for example, IRS Form W-8ECI or applicable successor form) and other disclosure requirements prior to the distribution date in order for effectively connected income to be exempt from the 30% U.S. federal withholding tax. A corporate non-U.S. holder also may be subject to an additional branch profits tax at a 30% rate (or such lower rate as may be specified by an applicable tax treaty) with respect to any effectively connected dividends, subject to certain adjustments.

Gain On Sale, Exchange or Other Taxable Disposition of Our Common Stock

In general, a non-U.S. holder will not be subject to any U.S. federal income tax or withholding tax on any gain realized upon such holder s sale, exchange or other taxable disposition of shares of our common stock unless:

- the gain is effectively connected with the non-U.S. holder s conduct of a trade or business within the United States (and if required by an applicable tax treaty, is attributable to a permanent establishment or a fixed base maintained by the non-U.S. holder in the United States), in which case the non-U.S. holder generally will be taxed on the net gain at the graduated U.S. federal income tax rates applicable to U.S. persons and, if the non-U.S. holder is a corporation, the additional branch profits tax described above in Distributions on Our Common Stock may apply;

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the non-U.S. holder is a nonresident alien individual who is present in the United States for 183 days or more in the taxable year of the disposition and certain other conditions are met, in which case the non-U.S. holder will be subject to a 30% tax (or such lower rate as may be specified by an applicable tax treaty) on the net gain derived from the disposition, which may be offset by U.S. source capital losses of the non-U.S. holder, if any; or

we are or have been, at any time during the five-year period preceding such disposition (or the non-U.S. holder s holding period if shorter) a U.S. real property holding corporation unless our common stock is regularly traded on an established securities market and the non-U.S. holder holds no more than 5% of our outstanding common stock, directly or indirectly during such period. If we are determined to be a U.S. real property holding corporation and the foregoing exception does not apply, then a purchaser may withhold 10% of the proceeds payable to a non-U.S. holder from a sale of our common stock and the non-U.S. holder generally will be taxed on its net gain derived from the disposition at the graduated U.S. federal income tax rates applicable to U.S. persons. Generally, a corporation is a U.S. real property holding corporation only if the fair market value of its U.S. real property interests equals or exceeds 50% of the sum of the fair market value of its worldwide real property interests plus its other assets used or held for use in a trade or business. Although there can be no assurance, we do not believe that we are, or have been, a U.S. real property holding corporation, or that we are likely to become one in the future.

U.S. Federal Estate Tax

Shares of our common stock owned or treated as owned at the time of death by an individual who is not a citizen or resident of the United States, as specifically defined for U.S. federal estate tax purposes, will be considered U.S. situs assets and will be included in such individual s gross estate for U.S. federal estate tax purposes. Such shares, therefore, may be subject to U.S. federal estate tax, unless an applicable tax treaty provides otherwise.

Information Reporting and Backup Withholding

Generally, we must report annually to the IRS and to non-U.S. holders the amount of distributions on our common stock paid to non-U.S. holders and the amount of tax, if any, withheld with respect to such distributions. Copies of the information returns reporting such distributions and withholding may also be made available to the tax authorities in the country in which a non-U.S. holder resides under the provisions of an applicable income tax treaty.

In general, a non-U.S. holder will not be subject to backup withholding with respect to distributions that we make, provided that the non-U.S. holder certifies that it is a non-U.S. holder on the applicable IRS form (for example, IRS Form W-8BEN) and we do not have actual knowledge or reason to know that the holder is a U.S. person, as defined under the Internal Revenue Code, who is not an exempt recipient. In addition, dividends paid to non-U.S. holders subject to the U.S. withholding tax, as described above in Distributions on Our Common Stock, generally will be exempt from backup withholding.

A non-U.S. holder will be subject to information reporting and, depending on the circumstances, backup withholding with respect to the proceeds of the sale of our common stock within the United States or conducted through certain U.S.-related financial intermediaries, unless the non-U.S. holder certifies that it is a non-U.S. holder on the applicable IRS form (for example, IRS Form W-8BEN), and the payor does not have actual knowledge or reason to know that the holder is a U.S. person, as defined under the Internal Revenue Code, who is not an exempt recipient, or the non-U.S. holder otherwise establishes an exemption.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against a non-U.S. holder s U.S. federal income tax liability, provided that the

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required information is furnished timely to the IRS. The backup withholding and information reporting rules are complex, and non-U.S. holders are urged to consult their own tax advisors regarding application of these rules to their particular circumstances.

Recent Legislative Developments

Recently enacted legislation, that is effective for amounts paid after December 31, 2012, generally will impose a withholding tax of 30% on any dividends on our common stock paid to a foreign financial institution, unless such institution enters into an agreement with the U.S. government to, among other things, collect and provide to the U.S. tax authorities substantial information regarding U.S. account holders of such institution (which includes certain equity and debt holders of such institution, as well as certain account holders that are foreign entities with U.S. owners). The legislation will also generally impose a withholding tax of 30% on any dividends on our common stock paid to a non-financial foreign entity unless such entity provides the withholding agent with either certification that such entity does not have any substantial United States owners or identification of the direct and indirect substantial U.S. owners of the entity. Finally, withholding of 30% also generally will apply to the gross proceeds of a disposition of our common stock paid to a foreign financial institution or to a non-financial foreign entity unless the reporting and certification requirements described above have been met. Under certain circumstances, a non-U.S. holder of our common stock may be eligible for refunds or credits of such taxes. Prospective non-U.S. holders are encouraged to consult with their tax advisors regarding the possible implications of this legislation on their investment in our common stock.

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UNDERWRITING

We intend to offer the shares through the underwriters. Citigroup Global Markets Inc., Morgan Stanley & Co. LLC, Barclays Capital Inc. and UBS Securities LLC are acting as the joint book-running managers for the offering and representatives of the underwriters named below. Subject to the terms and conditions described in a purchase agreement among us and the underwriters, the underwriters severally have agreed to purchase from us the number of shares listed opposite their names below.

Underwriter	Number of Shares
Citigroup Global Markets Inc.	
Morgan Stanley & Co. LLC	
Barclays Capital Inc.	
UBS Securities LLC	
Robert W. Baird & Co. Incorporated	
Jefferies & Company, Inc.	
Banca IMI S.p.A	
Mitsubishi UFJ Securities (USA), Inc.	
Wells Fargo Securities, LLC	
Total	17,500,000

The underwriters have agreed to purchase all of the shares sold under the purchase agreement if any of these shares are purchased. If an underwriter defaults, the purchase agreement provides that the purchase commitments of the non-defaulting underwriters may be increased or the purchase agreement may be terminated.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended, or to contribute to payments the underwriters may be required to make in respect of those liabilities.

The underwriters are offering the shares, subject to prior sale, when, as and if issued to and accepted by them, subject to approval of legal matters by their counsel, including the validity of the shares, and other conditions contained in the purchase agreement, such as the receipt by the underwriters of officer s certificates and legal opinions. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part.

Commissions and Discounts

The representatives have advised us that the underwriters propose initially to offer the shares to the public at the public offering price on the cover page of this prospectus supplement and to dealers at that price less a concession not in excess of $ per share. The underwriters may allow, and the dealers may reallow, a discount not in excess of $ per share to other dealers. After the public offering, the public offering price, concession and discount may be changed.

The following table shows the public offering price, underwriting discount and proceeds before expenses to us. The information assumes either no exercise or full exercise by the underwriters of their options.

	Per Share	Without Option	With Option
Public offering price	$	$	$
Underwriting discount	$	$	$
Proceeds, before expenses, to us	$	$	$

The expenses of the offering, not including the underwriting discount, are estimated at $1 million and are payable by us.

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Option to Purchase Additional Shares

We have granted options to the underwriters to purchase up to 1,750,000 additional shares at the public offering price less the underwriting discount. The underwriters may exercise these options for 30 days from the date of this prospectus supplement. If the underwriters exercise these options, each will be obligated, subject to conditions contained in the purchase agreement, to purchase a number of additional shares proportionate to that underwriter s initial amount reflected in the above table.

No Sales of Similar Securities

Pursuant to certain lock-up agreements, we and certain of our executive officers and directors have agreed, subject to certain exceptions, not to offer, sell, contract to sell, announce any intention to sell, pledge or otherwise dispose of, directly of indirectly, or file with the SEC a registration statement under the Securities Act relating to, any shares of common stock or securities convertible into or exchangeable or exercisable for any shares of common stock without the prior written consent of Morgan Stanley & Co. LLC for a period of 60 days after the date of this prospectus supplement. Specifically, we and these other individuals have agreed not to directly or indirectly:

- offer, pledge, sell or contract to sell any common stock;
- sell any option or contract to purchase any common stock;
- purchase any option or contract to sell any common stock;
- grant any option, right or warrant for the sale of any common stock;
- otherwise dispose of or transfer any common stock;
- file or cause to be filed a registration statement related to the common stock; or
- enter into any swap or other agreement that transfers, in whole or in part, the economic consequence of ownership of any common stock whether any such swap or transaction is to be settled by delivery of shares of common stock or other securities, in cash or otherwise.

This lock-up provision applies to common stock and to securities convertible into or exchangeable or exercisable for common stock. It also applies to common stock owned now or acquired later by the person executing the agreement or for which the person executing the agreement later acquires the power of disposition. The exceptions permit, among other things and subject to restrictions: (a) the issuance of equity awards or common stock pursuant to our existing employee benefit plans or a non-employee director stock plan and the issuance of common stock pursuant to the exercise of stock options, restricted stock units, warrants or other equity awards outstanding on the date hereof or the conversion of outstanding securities, (b) any equity award or issuance of common stock pursuant to any compensatory arrangement of Beckman Coulter, or the conversion of any existing plan or other compensatory arrangement of Beckman Coulter pursuant to the Merger Agreement, (c) any shares of common stock issued by us pursuant to the exercise of stock options, restricted stock units, warrants or other equity awards of Beckman Coulter provided such Beckman Coulter stock options, restricted stock units, warrants or other equity awards are being converted into securities of Danaher in accordance with the terms of the Merger Agreement and such securities are outstanding on the date hereof, (d) the filing of registration statements on Form S-8, and (e) certain bona fide gifts and other transfers relating to estate planning.

In addition, any transfer of common stock as a bona fide gift or gifts to The Glenstone Foundation or The Blue Dot Foundation, or any sale of such securities by the The Glenstone Foundation or The Blue Dot Foundation will not be subject to the lock-up provision, provided that (1) such transfers and sales are not required to be reported in any public report or filing with the SEC during the period of 60 days from the date of this prospectus supplement, and (2) the transferor does not otherwise voluntarily effect any public filing or report during the period of 60 days from the date of this prospectus supplement regarding such transfers or sales.

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New York Stock Exchange Listing

Our shares of common stock are listed on the New York Stock Exchange under the symbol DHR.

Price Stabilization, Short Positions

Until the distribution of the shares is completed, SEC rules may limit underwriters and selling group members from bidding for and purchasing our common stock. However, the representatives may engage in transactions that stabilize the price of the common stock, such as bids or purchases to peg, fix or maintain that price.

If the underwriters create a short position in the common stock in connection with the offering, i.e., if they sell more shares than are listed on the cover of this prospectus, the representatives may reduce that short position by purchasing shares in the open market. The representatives may also elect to reduce any short position by exercising all or part of the option described above. Purchases of the common stock to stabilize its price or to reduce a short position may cause the price of the common stock to be higher than it might be in the absence of such purchases.

Neither we nor any of the underwriters makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the common stock. In addition, neither we nor any of the underwriters makes any representation that the representatives will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

Selling Restrictions

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), each underwriter has severally represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date) it has not made and will not make an offer of common stock to the public in that Relevant Member State prior to the publication of a prospectus in relation to the common stock which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of common stock to the public in that Relevant Member State at any time:

(a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than 43,000,000 and (3) an annual net turnover of more than 50,000,000, as shown in its last annual or consolidated accounts;

(c) to fewer than 100, or, if the Relevant Member State has implemented the relevant provisions of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the representatives for any such offer; or

(d) in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an offer of common stock to the public in relation to any common stock in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the common stock to be offered so as to enable an investor to decide to purchase or subscribe the common stock, as the same may be varied in that Relevant Member State by

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any measure implementing the Prospectus Directive in that Relevant Member State and the expression Prospectus Directive means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive) and includes any relevant implementing measure in each Relevant Member State and the expression 2010 PD Amending Directive means Directive 2010/73/EU.

United Kingdom

Each underwriter has severally represented and agreed that it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services Markets Act 2000, as amended) received by it in connection with the issue or sale of the common stock in circumstances in which Section 21(1) of the FSMA does not apply.

Notice to Prospective Investors in Switzerland

This prospectus does not constitute an issue prospectus pursuant to Article 652a or Article 1156 of the Swiss Code of Obligations (CO) and the shares will not be listed on the SIX Swiss Exchange. Therefore, this prospectus may not comply with the disclosure standards of the CO and/or the listing rules (including any prospectus schemes) of the SIX Swiss Exchange. Accordingly, the shares may not be offered to the public in or from Switzerland, but only to a selected and limited circle of investors, which do not subscribe to the shares with a view to distribution.

Hong Kong

The shares may not be offered or sold by means of any document other than (i) in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap.32, Laws of Hong Kong), or (ii) to professional investors within the meaning of the Securities and Futures Ordinance (Cap.571, Laws of Hong Kong) and any rules made thereunder, or (iii) in other circumstances which do not result in the document being a prospectus within the meaning of the Companies Ordinance (Cap.32, Laws of Hong Kong), and no advertisement, invitation or document relating to the shares may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the laws of Hong Kong) other than with respect to shares which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) and any rules made thereunder.

Japan

The shares have not been and will not be registered under the Financial Instruments and Exchange Law of Japan, as amended (the FIEL), and disclosure under the FIEL has not been and will not be made with respect to the shares. Each underwriter has represented and agreed that the shares which its purchases will be purchased by it as principal and that, in connection with the offering and distribution of the shares, neither such underwriter nor any person acting on its behalf has offered or sold, or will offer or sell, any shares, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term shall mean any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for reoffering or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan, except (1) pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and (2) in compliance with any other applicable laws, regulations and governmental guidelines of Japan. As part of the offering, the underwriters may offer the shares in Japan to a list of 49 offerees in accordance with the above provisions.

Singapore

This prospectus has not been and will not be registered as a prospectus with the Monetary Authority of Singapore under the Securities and Futures Act, Cap. 289 of Singapore (the SFA). Accordingly, this prospectus

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or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the shares may not be circulated or distributed, nor may the shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to any person in Singapore other than under exemptions provided in the SFA for offers made (i) to an institutional investor, (ii) to a relevant person as defined under Section 275(2) and pursuant to Section 275(1) of the SFA, or any person pursuant to an offer referred to in Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA, (iii) by way of private placement to no more than 50 persons within any period of 12 months pursuant to, and in accordance with the conditions specified in, Section 272B of the SFA, or (iv) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the shares are subscribed for or purchased under Section 275 of the SFA by a relevant person that is specified in Section 276 of the SFA, namely (a) a corporation (which is not an accredited investor as defined under Section 4A of the SFA) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an accredited investor, the shares, debentures and units of shares and debentures of that corporation or the beneficiaries rights and interest (howsoever described) in that trust shall not be transferable for six months after that corporation or that trust has acquired the shares pursuant to an offer made under Section 275 of the SFA, except: (1) to an institutional investor under Section 274 of the SFA or to a relevant person defined in Section 275(2) of the SFA, or to any person pursuant to an offer that is made on terms that such shares, debentures and units of shares and debentures of that corporation or such rights or interest in that trust are acquired at a consideration of not less than 200,000 Singapore dollars (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions specified in Section 275(1A) of the SFA; (2) where no consideration is or will be given for the transfer; or (3) where the transfer is by operation of law.

Other Relationships

Certain of the underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for us, for which they received or will receive customary fees and expenses. In addition, certain of the underwriters and/or their respective affiliates have been or are lenders under one or more of our credit facilities.

Banca IMI S.p.A. is not a U.S. registered broker-dealer and will not effect any offers or sales of any shares of common stock in the United States unless it is through one or more U.S. registered broker-dealers as permitted by the regulations of the Financial Industry Regulatory Authority, Inc.

LEGAL MATTERS

Certain legal matters in connection with the offering of the shares will be passed upon for us by Wilmer Cutler Pickering Hale and Dorr LLP. Certain legal matters in connection with the offering of the shares will be passed upon for the underwriters by Weil, Gotshal & Manges LLP, New York, New York.

EXPERTS

Ernst & Young LLP, independent registered public accounting firm, has audited our consolidated financial statements included in our Current Report on Form 8-K filed on April 21, 2011, and the effectiveness of our internal control over financial reporting as of December 31, 2010, as set forth in their reports, which are incorporated by reference in this prospectus and elsewhere in the registration statement. Our financial statements are incorporated by reference in reliance on Ernst & Young LLP s reports, given on their authority as experts in accounting and auditing.

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PROSPECTUS

Danaher Corporation

Senior Debt Securities

Subordinated Debt Securities

Preferred Stock

Common Stock

Warrants

Depositary Shares

Purchase Contracts

Units

Danaher Corporation may offer and sell the securities listed above from time to time in one or more classes or series and in amounts, at prices and on terms that we may determine at the time of the offering. We will provide the specific terms of the securities in one or more supplements to this prospectus. In addition, selling securityholders may sell these securities, from time to time, on terms described in the applicable prospectus supplement. You should read this prospectus, any prospectus supplement and any free writing prospectus that we file with the Securities and Exchange Commission, together with the information contained in the documents referred to under the heading Where You Can Find More Information , carefully before you invest in our securities.

Our common stock is listed on the New York Stock Exchange under the symbol DHR .

We and/or the selling securityholders may offer and sell these securities to or through one or more underwriters, dealers and agents, or directly to purchasers, on a continuous or delayed basis.

You should carefully consider the risk factors included in our periodic reports filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, and the applicable prospectus supplement before you invest in any of our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is May 8, 2009.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement on Form S-3 that we filed with the Securities and Exchange Commission, which we refer to as the SEC, using a shelf registration process. Under this shelf registration process, we and/or selling securityholders may offer and sell any combination of the securities described in this prospectus in one or more offerings from time to time. This prospectus provides you with a general description of the securities we and/or or selling securityholders may offer. Each time we or any selling securityholder uses this prospectus to offer securities, we will provide a prospectus supplement and/or free writing prospectus that will describe the specific type, amount, price and other material terms of the securities being offered at that time. The prospectus supplement and/or any applicable free writing prospectus may also add, update or change the information in this prospectus. You should read this prospectus, any prospectus supplement and any free writing prospectus or other offering material that we authorize, together with the information contained in the documents referred to under the heading Where You Can Find More Information.

When acquiring any securities discussed in this prospectus, you should rely only on the information contained or incorporated by reference in this prospectus, any prospectus supplement or any free writing prospectus that we file with the Securities and Exchange Commission. We have not authorized anyone to provide you with different information. We are not offering the securities in any jurisdiction in which an offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to anyone to whom it is unlawful to make an offer or solicitation.

You should not assume that the information in this prospectus, any prospectus supplement, any free writing prospectus or other offering material that we authorize or any document incorporated by reference, is truthful or complete at any date other than the date mentioned on the cover page of those documents.

Unless otherwise indicated or unless the context requires otherwise, when used in this prospectus, the terms Danaher, we, our and us refer to Danaher Corporation and its consolidated subsidiaries.

FORWARD-LOOKING INFORMATION

Certain information included or incorporated by reference in this prospectus, any applicable prospectus supplement or in our communications and discussions through webcasts, conference calls and other presentations, may be deemed to be forward-looking statements within the meaning of the federal securities laws. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including statements regarding: projections of revenue, profit, profit margins, expenses and cost-reduction activities, our effective tax rate, our tax provisions and changes to our tax provisions, tax audits, cash flows, liquidity position, pension and benefit obligations and funding requirements, our liquidity position or other financial measures; plans, strategies and objectives of management for future operations, including statements relating to anticipated operating performance, new product and service developments, purchase commitments, potential acquisitions and synergies, potential offerings of securities, our stock repurchase program and executive compensation; growth and other trends in markets we sell into; economic conditions and the anticipated duration of the current economic downturn; the impact of adopting new accounting pronouncements; the outcome of outstanding claims, legal proceedings or other contingent liabilities; planned restructuring activities, including estimates of the scope, timing and cost of such activities; assumptions underlying any of the foregoing; and any other statements that address activities, events or developments that Danaher intends, expects, projects, believes or anticipates will or may occur in the future. Forward-looking statements may be characterized by terminology such as believe, anticipate, should, would, intend, plan, expects, estimates, projects, positioned, strategy and similar expressions. These statements are based on assumptions and assessments made our management in light of their experience and perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. These forward-looking statements are subject to a number of risks and uncertainties, including but not limited to the following:

- Deteriorating general economic conditions and uncertainties in the global financial markets may adversely affect our operating results and financial condition.

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We face intense competition and if we are unable to compete effectively, we may face decreased demand or price reductions for our products.

Our growth depends in part on the timely development and commercialization, and customer acceptance, of new products and product enhancements based on technological innovation.

Our revenues could decline further if the markets into which we sell our products continue to decline or do not grow as anticipated.

Our acquisition of businesses could negatively impact our profitability and return on invested capital.

Any inability to consummate acquisitions at our prior rate could negatively impact our growth rate.

The indemnification provisions of acquisition agreements by which we have acquired companies may not fully protect us and may result in unexpected liabilities.

Contingent liabilities from businesses that we have sold could adversely affect our results of operations and financial condition.

Our indebtedness may limit our operations and our use of our cash flow.

We may be required to recognize impairment charges for our long-lived assets.

Foreign currency exchange rates may adversely affect our results of operations and financial condition.

If we do not or cannot adequately protect our intellectual property, or if third parties infringe our intellectual property rights, we may suffer competitive injury or expend significant resources enforcing our rights.

Third parties may claim that we are infringing or misappropriating their intellectual property rights and we could suffer significant litigation expenses, losses or licensing expenses or be prevented from selling products or services.

We are subject to a variety of litigation in the course of our business that could adversely affect our results of operations and financial condition.

Our operations expose us to the risk of environmental liabilities, costs, litigation and violations that could adversely affect our financial condition, results of operations and reputation.

Our businesses are subject to extensive regulation; failure to comply with those regulations could adversely affect our results of operations, financial condition and reputation.

Our reputation and our ability to do business may be impaired by improper conduct by any of our employees, agents or business partners.

Changes in our tax rates or exposure to additional income tax liabilities could affect our profitability. In addition, audits by tax authorities could result in additional tax payments for prior periods.

Our defined benefit pension plans are subject to financial market risks that could adversely affect our results of operations and cash flows.

We have experienced and may continue to experience higher costs to produce our products as a result of rising prices for commodities.

If we cannot adjust our purchases of materials, components and equipment required for our manufacturing activities to reflect changing market conditions or customer demand, our income and results of operations may suffer.

If we cannot adjust our manufacturing capacity to reflect the demand for our products, our income and results of operations may suffer.

Changes in governmental regulations may reduce demand for our products or increase our expenses.

Work stoppages, union and works council campaigns, labor disputes and other matters associated with our labor force could adversely impact our results of operations and cause us to incur incremental costs.

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Adverse changes in our relationships with, or the financial condition or performance of, key distributors, resellers and other channel partners could adversely affect our results of operations.

The inability to hire, train and retain a sufficient number of qualified officers and other employees could impede our ability to compete successfully.

International economic, political, legal and business factors could negatively affect our results of operations, cash flows and financial condition.

Cyclical economic conditions have affected and may continue to adversely affect our financial condition and results of operations.

If we suffer loss to our facilities, distribution systems or information technology systems due to catastrophe, our operations could be seriously harmed.

Any such forward-looking statements are not guarantees of future performance and actual results, developments and business decisions may differ materially from those envisaged by such forward-looking statements. Forward-looking statements speak only as of the date of the document, webcast, call or other presentation in which they are made. We do not assume any obligation to update any forward-looking statement. See the risk factors included in our periodic reports filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the Securities Exchange Act), and in any applicable prospectus supplement for a further discussion regarding some of the reasons that actual results may be materially different from those that we anticipate.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC under the Securities Exchange Act. You may read and copy all or any portion of this information at the SEC s Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the operation of its Public Reference Room. Our SEC filings are also available at the offices of the New York Stock Exchange, 20 Broad Street, New York, NY 10005.

The SEC also maintains a web site that contains reports, proxy and information statements and other information about issuers, like Danaher, who file electronically with the SEC. The address of that site is www.sec.gov.

Our website address is www.danaher.com. This reference to our website is intended to be an inactive textual reference only. Our website and the information contained in or linked to our website are not incorporated by reference into this prospectus.

This prospectus is part of the registration statement and does not contain all of the information included in the registration statement. Whenever a reference is made in this prospectus to any contract or other document of Danaher, the reference may not be complete and you should refer to the exhibits that are a part of the registration statement for a copy of the contract or document.

The SEC allows us to incorporate by reference information into this prospectus, which means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is deemed to be part of this prospectus, except for any information that is superseded by subsequent incorporated documents or by information that is contained directly in this prospectus or any prospectus supplement. This prospectus incorporates by reference the documents set forth below that Danaher has previously filed with the SEC and that are not delivered with this prospectus. These documents contain important information about Danaher and its financial condition.

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Danaher SEC Filings (File No. 1-08089)	Period
Annual Report on Form 10-K	Fiscal year ended December 31, 2008
Quarterly Report on Form 10-Q	Quarterly period ended April 3, 2009
Current Reports on Form 8-K	Filed on March 3, March 6 and May 5, 2009
The description of Danaher common stock as set forth in its Registration Statement on Form 8-B, including all amendments and reports filed for the purpose of updating such description	Filed on November 3, 1986

All documents filed by us pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act (excluding any information furnished under Items 2.02, 7.01 or 8.01 in any Current Report on Form 8-K) on or after the date of this prospectus and before the termination of the offering of securities under this prospectus shall also be deemed to be incorporated herein by reference. Any statement contained in any document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or in any other subsequently filed document which also is or is deemed to be incorporated by reference in this prospectus modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

To obtain a copy of these filings at no cost, you may write or telephone us at:

Danaher Corporation

2099 Pennsylvania Avenue, N.W., 12th Floor

Washington, D.C. 20006-1813

Attention: Investor Relations

(202) 828-0850

Exhibits to the filings will not be sent, however, unless those exhibits have specifically been incorporated by reference into such document.

DANAHER CORPORATION

Danaher Corporation derives its sales from the design, manufacture and marketing of professional, medical, industrial, commercial and consumer products, which are typically characterized by strong brand names, proprietary technology and major market positions. Danaher s business consists of four segments: Professional Instrumentation, Medical Technologies, Industrial Technologies, and Tools & Components.

Danaher Corporation was incorporated in the State of Delaware in 1986, and our principal executive offices are located at 2099 Pennsylvania Avenue, N.W., 12th Floor, Washington, D.C. 20006- 1813. Our telephone number is (202) 828-0850.

For additional information concerning Danaher, please see our most recent Annual Report on Form 10-K and our other filings with the SEC, which are incorporated by reference into this document. See Where You Can Find More Information.

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USE OF PROCEEDS

Unless we inform you otherwise in a prospectus supplement or free writing prospectus, we expect to use the net proceeds from the sale of securities for general corporate purposes. These purposes may include, but are not limited to:

- reduction or refinancing of debt or other corporate obligations;
- acquisitions;
- capital expenditures;
- share repurchases and dividends; and
- working capital.

Pending any specific application, we may initially invest funds in short- term marketable securities or apply them to the reduction of short-term indebtedness. We will not receive any of the proceeds from the sale of securities covered by this prospectus that are sold by the selling securityholders.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to fixed charges for each of the periods indicated.

	Fiscal Year Ended December 31					
	2004	**2005**	**2006**	**2007**	**2008**	**Quarter ended April 3, 2009**
Ratio of Earnings to Fixed Charges	17.3x	23.0x	16.6x	14.1x	13.4x	12.8x

The ratio of earnings to fixed charges was computed by dividing earnings by fixed charges for the periods indicated, where earnings consist of (1) earnings from continuing operations before income taxes; plus (2) fixed charges, and fixed charges consist of (A) interest, whether expensed or capitalized, on all indebtedness, (B) amortization of premiums, discounts and capitalized expenses related to indebtedness, and (C) an interest component representing the estimated portion of rental expense that management believes is attributable to interest. Interest on FIN 48 liabilities is included in the tax provision in our consolidated condensed statement of earnings and is excluded from the computation of fixed charges.

DESCRIPTION OF DEBT SECURITIES

This section describes the general terms and provisions of the debt securities that we may issue separately, upon exercise of a debt warrant, in connection with a purchase contract or as part of a unit from time to time in the form of one or more series of debt securities. The applicable prospectus supplement and/or free writing prospectus will describe the specific terms of the debt securities offered through that prospectus supplement as well as any general terms described in this section that will not apply to those debt securities. As used in this prospectus, debt securities means the senior and subordinated debentures, notes, bonds and other evidences of indebtedness that we issue and a trustee authenticates and delivers under the applicable indenture. As used in this Description of Debt Securities, the terms Danaher, we, our and us r to Danaher Corporation and do not, unless the context otherwise indicates, include our subsidiaries.

Senior debt securities will be issued under an indenture dated December 11, 2007 between Danaher and The Bank of New York Mellon Trust Company, N.A., as trustee, that has been filed as an exhibit to the registration statement of which this prospectus is a part and is incorporated by reference into this prospectus, subject to such amendments or supplemental indentures as are adopted, from time to time, including the supplemental indenture dated as of December 11, 2007 and the supplemental indenture dated as of March 5, 2009. This indenture is referred to as the senior indenture . Subordinated debt securities will be issued under a separate indenture to be entered into by us and a trustee or trustees identified in the prospectus supplement, the form of which is included as an exhibit to the registration statement of which this prospectus is a part and is incorporated by reference into this prospectus. This indenture is referred to as the subordinated indenture . We refer to the indentures described above as the indentures or the indenture, as applicable. The following summaries of certain provisions of the indentures and the debt securities are not complete and the summaries are subject to the detailed provisions of the applicable indenture. You should refer to the applicable indenture for more specific information. In addition, you should consult the applicable prospectus supplement and/or free writing prospectus for particular terms of our debt securities.

The indentures will not limit the aggregate principal amount of debt securities that we may issue, and will permit us to issue securities from time to time in one or more series. The general provisions of the indentures do not contain any provisions that would limit our ability to incur indebtedness or that would afford holders of debt securities protection in the event of a highly leveraged or similar transaction involving us. However, the senior indenture does restrict us and our subsidiaries from granting certain security interests on certain of our or their property or assets unless the senior debt securities are equally secured. See Covenants in the Senior Indenture below.

The debt securities will be unsecured obligations of Danaher. We currently conduct substantially all of our operations through subsidiaries, and the holders of debt securities (whether senior or subordinated debt securities) will be effectively subordinated to the creditors of our subsidiaries. This means that creditors of our subsidiaries will have a claim to the assets of our subsidiaries that is superior to the claim of our creditors, including holders of our debt securities.

The applicable prospectus supplement and/or free writing prospectus will describe the following terms of any series of debt securities that we may offer:

- the title and type of the debt securities;

- whether the debt securities will be senior or subordinated debt securities, and, with respect to debt securities issued under the subordinated indenture, as applicable, that the subordination provisions of the indenture shall apply to the securities of that series or that any different subordination provisions, including different definitions of the terms senior indebtedness or existing subordinated indebtedness, shall apply to securities of that series;

- any limit on the aggregate principal amount of the debt securities;

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the person who will receive interest payments on any debt securities if other than the registered holder;

the price or prices at which we will sell the debt securities;

the maturity date or dates of the debt securities;

the rate or rates, which may be fixed or variable, per annum at which the debt securities will bear interest and the date from which such interest will accrue;

the dates on which interest will be payable and the related record dates;

whether any index, formula or other method will determine payments of principal, premium or interest and the manner of determining the amount of such payments;

the place or places of payments on the debt securities;

whether the debt securities are redeemable;

any redemption dates, prices, obligations and restrictions on the debt securities;

any mandatory or optional sinking fund or purchase fund or analogous provisions;

the denominations of the debt securities if other than $1,000 or multiples of $1,000;

the currency of principal and interest payments if other than U.S. dollars, and the manner of determining the equivalent thereof in U.S. dollars for any purpose under the indenture;

if the principal of or any premium or interest on any debt securities of any series is payable, at our election or the election of the holder, in one or more currencies other than that in which such debt securities are stated to be payable, the currency or currencies in which such principal, premium or interest shall be payable and other terms and conditions regarding such payment;

the amount that we will pay the holder if the maturity of the debt securities is accelerated, if other than their principal amount;

the amount that will be deemed to be the principal amount of the debt securities as of a particular date before maturity if the principal amount payable at the stated maturity date will not be able to be determined on that date;

the applicability of the legal defeasance and covenant defeasance provisions in the applicable indenture;

if the debt securities will be issued only in the form of one or more book-entry securities, the name of the depositary or its nominee and the circumstances under which the book-entry security may be transferred or exchanged to someone other than the depositary or its nominee;

any provisions granting special rights if certain events happen;

any deletions from, changes in or additions to the events of default or the covenants specified in the indenture, or to the right of the trustee or the requisite holders of such securities to declare the principal amount of such securities due and payable;

any trustees, authenticating or paying agents, transfer agents, registrars or other agents for the debt securities;

any conversion or exchange features of the debt securities;

whether we will issue the debt securities as original issue discount securities for federal income tax purposes;

any special tax implications of the debt securities;

the terms of payment upon acceleration; and

any other material terms of the debt securities not inconsistent with the provisions of the indenture.

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Debt securities may bear interest at fixed or floating rates. We may issue our debt securities at an original issue discount, bearing no interest or bearing interest at a rate that, at the time of issuance, is below market rate, to be sold at a substantial discount below their stated principal amount. Generally speaking, if our debt securities are issued at an original issue discount and there is an event of default or acceleration of their maturity, holders will receive an amount less than their principal amount. Tax and other special considerations applicable to any series of debt securities, including original issue discount securities, will be described in the prospectus supplement in which we offer those debt securities.

We will have the ability under the indenture to reopen a previously issued series of debt securities and issue additional debt securities of that series or establish additional terms of the series. We are also permitted to issue debt securities with the same terms as previously issued debt securities.

We will comply with Section 14(e) under the Exchange Act and any other tender offer rules under the Exchange Act that may then apply to any obligation we may have to purchase debt securities at the option of the holders. Any such obligation applicable to a series of debt securities will be described in the related prospectus supplement.

Payment and Paying Agents

Unless the applicable prospectus supplement indicates otherwise, payment of interest on a debt security (other than a bearer debt security) on any interest payment date will be made to the person in whose name such debt security is registered at the close of business on the regular record date for such interest payment.

Generally, we will pay the principal of, premium, if any, and interest on our registered debt securities either at the office of the paying agent designated by us in the applicable prospectus supplement or, if we elect, we may pay interest by mailing a check to your address as it appears on our register or by wire transfer to an account maintained by the person entitled thereto as specified in the securities register. We may at any time designate additional paying agents or rescind the designation of any paying agent or approve a change in the office through which any paying agent acts, except that we will be required to maintain a paying agent in each place of payment for the debt securities of a particular series.

All moneys paid by us to a paying agent or the trustee, or held, for the payment of the principal of or any premium or interest on any debt security which remain unclaimed at the end of two years after such principal, premium or interest has become due and payable will be repaid to us, or discharged from trust, and the holder of such debt security shall thereafter, as an unsecured general creditor, look only to us for payment thereof, subject to applicable escheat laws.

Senior Debt Securities

Senior debt securities will be issued under the senior indenture. Payment of the principal of, premium, if any, and interest on senior debt securities will rank equally with all of our other unsecured and unsubordinated debt.

Subordinated Debt Securities

Subordinated debt securities will be issued under the subordinated indenture. Subordinated debt securities of a particular series will be subordinate in right of payment, to the extent and in the manner set forth in the subordinated indenture and the prospectus supplement relating to those subordinated debt securities, to the prior payment of all of our indebtedness that is designated as senior indebtedness with respect to that series. The definition of senior indebtedness will include, among other things, senior debt securities and will be specifically set forth in that prospectus supplement.

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Upon any payment or distribution of our assets to creditors or upon our total or partial liquidation or dissolution or in a bankruptcy, receivership, or similar proceeding relating to us or our property, holders of senior indebtedness will be entitled to receive payment in full of the senior indebtedness before holders of subordinated debt securities will be entitled to receive any payment with respect to the subordinated debt securities and, until the senior indebtedness is paid in full, any distribution to which holders of subordinated debt securities would otherwise be entitled (other than securities of Danaher or any other corporation provided for by a plan of reorganization or readjustment the payment of which is subordinate, at the least to the extent provided pursuant to these subordination provisions, to the payment of all senior indebtedness then outstanding and to any securities issued in respect thereof under any such plan of reorganization or readjustment) will be made to the holders of senior indebtedness, all as described in the applicable prospectus supplement. In the event of any such proceeding, after payment in full of all sums owing with respect to senior indebtedness, the holders of subordinated debt securities, together with the holders of any of our obligations ranking on a parity with the subordinated debt securities, will be entitled to be paid from our remaining assets the amounts then due and owing with respect to such subordinated debt securities and other obligations, before any payments or distributions will be made on account of any of our capital stock or other obligations ranking junior to such subordinated debt securities and other obligations.

If we default in the payment of any principal of, premium, if any, or interest on any senior indebtedness, whether at maturity or at a date fixed for prepayment or by declaration of acceleration or otherwise, then, upon written notice of such default to us by the holders of senior indebtedness or any trustee therefor, unless and until such default shall have been cured or waived or shall have ceased to exist, no direct or indirect payment shall be made or agreed to be made on account of the principal, premium, if any, or interest on any of the subordinated debt securities, or in respect of any redemption, repayment, retirement, purchase or other acquisition of any of the subordinated debt securities.

By reason of this subordination, in the event of insolvency, our creditors who are holders of senior indebtedness or holders of any indebtedness or preferred stock of our subsidiaries, as well as certain of our general creditors, may recover more, ratably, than the holders of the subordinated debt securities.

Events of Default

Except as may be provided otherwise in a prospectus supplement, any of the following events will constitute an event of default for a series of debt securities under the indenture:

- failure to pay interest on our debt securities of that series for thirty days past the applicable due date;
- failure to pay principal of, or premium, if any, on our debt securities of that series when due (whether at maturity, upon acceleration or otherwise);
- failure to deposit any sinking fund payment on debt securities of that series when due;
- failure to perform, or breach of, any other covenant, agreement or warranty for the benefit of the holders of the security in the indenture, other than a covenant, agreement or warranty a default in whose performance or breach is dealt with elsewhere in the indenture, or which is included in the indenture solely for the benefit of a different series of our debt securities, which continues for 90 days after written notice from the trustee or holders of 25% of the outstanding principal amount of the debt securities of that series as provided in the indenture;
- specified events relating to our bankruptcy, insolvency or reorganization; and
- any other event of default provided with respect to debt securities of that series pursuant to the applicable supplement.

An event of default with respect to one series of debt securities is not necessarily an event of default for another series.

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If there is an event of default with respect to a series of our debt securities, which continues for the requisite amount of time, either the trustee or holders of at least 25% of the aggregate principal amount outstanding of that series may declare the principal amount of all of the debt securities of that series to be due and payable immediately, except that if an event of default occurs due to bankruptcy, insolvency or reorganization as provided in the applicable indenture, then the principal of and interest on the debt securities shall become due and payable immediately without any act by the trustee or any holder of debt securities. If the securities were issued at an original issue discount, less than the stated principal amount may become payable. However, at any time after an acceleration with respect to debt securities of any series has occurred, but before a judgment or decree based on such acceleration has been obtained, the holders of a majority in principal amount of the outstanding debt securities of that series may, under certain circumstances, rescind and annul such acceleration.

The holders of a majority in aggregate principal amount of the outstanding debt securities of a series may, on behalf of the holders of all debt securities of that series, waive any past default or event of default and its consequences for that series, except (1) a default in the payment of the principal, premium, or interest with respect to those debt securities or (2) a default with respect to a provision of the applicable indenture that cannot be amended without the consent of each holder affected by the amendment. In case of a waiver of a default, that default shall cease to exist, and any event of default arising from that default shall be deemed to have been cured for all purposes. The holders of a majority in aggregate principal amount outstanding of the debt securities of any series may also, on behalf of the holders of all debt securities of that series, waive, with respect to that series, our compliance with certain restrictive covenants in the applicable indenture.

If any event which is, or after notice or lapse of time or both would become, an event of default (collectively referred to in this paragraph as a default) occurs and is continuing with respect to debt securities of a particular series and if it is known to any specified responsible officer of the trustee, the trustee will mail to each holder of such debt securities notice of such default within 90 days after it occurs or, if later, after the trustee obtains knowledge of such default. Except in the case of default in the payment of principal, premium, or interest with respect to the debt securities of that series or in the making of any sinking fund payment with respect to the debt securities of that series, the trustee may withhold such notice if and so long as the corporate trust committee or a committee of specified responsible officers of the trustee in good faith determines that withholding the notice is in the interests of the holders of such debt securities.

A holder may institute a suit against us for enforcement of such holder s rights under the applicable indenture, for the appointment of a receiver or trustee, or for any other remedy only if the following conditions are satisfied:

- the holder gives the trustee written notice of a continuing event of default with respect to a series of our debt securities held by that holder;

- holders of at least 25% of the aggregate principal amount of the outstanding debt securities of that series make a request, in writing, and offer reasonable indemnity, to the trustee for the trustee to institute the requested proceeding;

- the trustee does not receive direction contrary to the holder s request from holders of a majority in aggregate principal amount of the outstanding debt securities of that series within 60 days following such notice, request and offer of indemnity under the terms of the applicable indenture; and

- the trustee does not institute the requested proceeding within 60 days following such notice.

The indentures will require us every year to deliver to the trustee a statement as to performance of our obligations under the indentures and as to any defaults.

A default in the payment of any of our debt securities, or a default with respect to our debt securities that causes them to be accelerated, may give rise to a cross-default under our other indebtedness.

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Satisfaction and Discharge of the Indentures

An indenture will generally cease to be of any further effect with respect to a series of debt securities if:

- we have delivered to the applicable trustee for cancellation all debt securities of that series (with certain limited exceptions); or
- all debt securities of that series not previously delivered to the trustee for cancellation have become due and payable, will become due and payable within one year, or are to be called for redemption within one year under arrangements satisfactory to the trustee, and in any such case we have deposited with the trustee as trust funds the entire amount sufficient to pay at maturity or upon redemption all of the principal, premium and interest due with respect to those debt securities;

and if, in either case, we also pay or cause to be paid all other sums payable under the applicable indenture by us and deliver to the trustee an officer s certificate and opinion of counsel stating that all conditions precedent to the satisfaction and discharge of the indenture have been complied with.

Legal Defeasance And Covenant Defeasance

Any series of our debt securities will be subject to the defeasance and discharge provisions of the applicable indenture unless otherwise specified in the applicable prospectus supplement. If those provisions are applicable, we may elect either:

- legal defeasance, which will permit us to defease and be discharged from, subject to limitations, all of our obligations with respect to those debt securities, including any subordination provisions; or
- covenant defeasance, which will permit us to be released from our obligations to comply with certain covenants relating to those debt securities as described in the applicable prospectus supplement, which may include obligations concerning subordination of our subordinated debt securities.

If we exercise our legal defeasance option with respect to a series of debt securities, payment of those debt securities may not be accelerated because of an event of default. If we exercise our covenant defeasance option with respect to a series of debt securities, payment of those debt securities may not be accelerated because of an event of default related to the specified covenants.

Unless otherwise provided in the applicable prospectus supplement, we may invoke legal defeasance or covenant defeasance with respect to any series of our debt securities only if:

- with respect to debt securities denominated in U.S. dollars, we irrevocably deposit with the trustee, in trust, an amount in U.S. dollars, U.S. government obligations (taking into account payment of principal and interest thereon in accordance with their terms) or a combination thereof which will provide money in an amount sufficient to pay, when due upon maturity or redemption, as the case may be, the principal of, premium, if any, and interest on those debt securities;
- with respect to debt securities denominated in a currency other than U.S. dollars, we irrevocably deposit with the trustee, in trust, an amount in such currency, obligations of the foreign government that issued such currency (taking into account payment of principal and interest thereon in accordance with their terms) or a combination thereof which will provide money in an amount sufficient to pay, when due upon maturity or redemption, as the case may be, the principal of, premium, if any, and interest on those debt securities;

we deliver to the trustee a certificate from a nationally recognized firm of independent accountants expressing their opinion that the payments of principal and interest when due on the deposited U.S. government obligations or foreign government obligations, as applicable, plus any deposited money will provide cash at such times and in such amounts as will be sufficient to pay the principal, premium, and interest when due with respect to all the debt securities of that series to maturity or redemption, as the case may be;

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no event which is, or after notice or lapse of time would become, an event of default under the indenture shall have occurred and be continuing at the time of such deposit or, with regard to any default relating to our bankruptcy, insolvency or reorganization, at any time on or prior to the 90th day after such deposit;

the deposit does not cause the trustee to have a conflicting interest within the meaning of the Trust Indenture Act (assuming all securities under the indenture are in default within the meaning of such Act);

the deposit is not a default under any other agreement binding on us;

such deposit will not result in the trust arising from such deposit constituting an investment company under the Investment Company Act of 1940, as amended, unless such trust is registered under, or exempt from, such Act;

we deliver to the trustee an opinion of counsel addressing certain federal income tax matters relating to the defeasance;

if the securities are to be redeemed prior to the stated maturity (other than from mandatory sinking fund payments or analogous payments), notice of such redemption shall have been duly given or provision for such notice satisfactory to the trustee shall have been made;

with respect to any series of subordinated debt securities, at the time of such deposit, (1) no default in the payment of principal, premium or interest with respect to any senior indebtedness shall have occurred and be continuing, (2) no event of default shall have resulted in any senior indebtedness becoming, and continuing to be, due and payable prior to the date it would otherwise have become due and payable (unless payment of such senior indebtedness has been provided for), and (3) no other event of default shall have occurred and be continuing which permits the holders thereof to declare such indebtedness due and payable prior to the date it would otherwise have become due and payable; and

we deliver to the trustee an officers certificate and an opinion of counsel, each stating that all conditions precedent to the defeasance and discharge of the debt securities of that series as contemplated by the applicable indenture have been complied with.

Modification and Waiver

We and the trustee may enter into supplemental indentures for the purpose of modifying or amending an indenture with the consent of holders of at least a majority in aggregate principal amount of each series of our outstanding debt securities affected. However, unless otherwise provided in the applicable prospectus supplement, the consent of all of the holders of our debt securities that are affected thereby is required for any of the following modifications or amendments:

to reduce the percentage in principal amount of debt securities of any series whose holders must consent to a supplemental indenture, or consent to any waiver of compliance with certain provisions of the indenture, or consent to certain defaults under the indenture, in each case as provided for in the indenture;

to reduce the rate of, or change the stated maturity of any installment of, interest on any debt security;

to reduce the principal of or change the stated maturity of principal of, or any installment of principal of or interest on, any debt security or reduce the amount of principal of any original issue discount security that would be due and payable upon declaration of acceleration of maturity;

to reduce the premium payable upon the redemption of any debt security;

to make any debt security, or any premium or interest thereon, payable in a currency other than that stated in that debt security;

to change any place of payment where any debt security or any premium or interest thereon is payable;

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- to change the right to convert any debt security in accordance with its terms;

- to impair the right to bring a lawsuit for the enforcement of any payment on or after the stated maturity of any debt security (or in the case of redemption, on or after the date fixed for redemption);

- to modify the provisions of the indenture with respect to subordination of debt securities in a manner adverse to any registered holder of a debt security; or

- generally, to modify any of the above provisions of the indenture or any provisions providing for the waiver of past defaults or waiver of compliance with certain covenants, except to increase the percentage in principal amount of debt securities of any series whose holders must consent to an amendment or waiver, as applicable, or to provide that certain other provisions of the indenture cannot be modified or waived without the consent of the holder of each outstanding debt security affected by the modification or waiver.

In addition, we and the trustee with respect to an indenture may enter into supplemental indentures without the consent of the holders of debt securities for one or more of the following purposes (in addition to any other purposes specified in an applicable prospectus supplement):

- to evidence that another person has become our successor and that the successor assumes our covenants, agreements, and obligations in the indenture and in the debt securities;

- to surrender any of our rights or powers under the indenture, or to add to our covenants further covenants for the protection of the holders of all or any series of debt securities;

- to add any additional events of default for the benefit of the holders of all or any series of debt securities;

- to cure any ambiguity, to correct or supplement any provision in the indenture that may be defective or inconsistent with any other provision in the indenture, or to make other provisions in regard to matters or questions arising under the indenture;

- to add to or change any of the provisions of the indenture as necessary to permit or facilitate the issuance of debt securities in bearer form, registrable or not registrable as to principal, and with or without interest coupons, or to permit or facilitate the issuance of debt securities in uncertificated form;

- to secure the debt securities;

- to add to, change, or eliminate any of the provisions of the indenture with respect to one or more series of debt securities, so long as the addition, change, or elimination not otherwise permitted under the indenture will (1) neither apply to any debt security of any series created before the execution of the supplemental indenture and entitled to the benefit of that provision nor modify the rights of the holders of that debt security with respect to that provision or (2) become effective only when there is none of that debt security outstanding;

- to evidence and provide for the acceptance of appointment by a successor or separate trustee with respect to the debt securities of one or more series and to add to or change any of the provisions of the indenture as necessary to provide for the administration of the indenture by more than one trustee;

with respect to the subordinated indenture, to add to, change or eliminate any of the subordination provisions in the indenture or change the definition of "senior indebtedness" in respect of one or more series of debt securities, provided that any such addition, change or elimination does not adversely affect the interests of the holders of outstanding debt securities in any material respect;

to establish the form or terms of debt securities of any series; and

to make provisions with respect to the conversion rights of holders, including providing for the conversion of debt securities of any series into any security or securities of ours.

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Certain Covenants

In addition to such other covenants, if any, as may be described in the accompanying prospectus supplement and/or free writing prospectus and except as may be otherwise set forth in the accompanying prospectus supplement and/or free writing prospectus, the indenture will require us, subject to certain limitations described therein, to, among other things, do the following:

- deliver to the trustee all information, documents and reports required to be filed by us with the SEC under Section 13 or 15(d) of the Exchange Act, within 15 days after the same is filed with the SEC;

- deliver to the trustee annual officers certificates with respect to our compliance with our obligations under the indenture;

- maintain the existence, rights and franchises of us and our significant subsidiaries, except to the extent our board of directors determines that the preservation thereof is no longer desirable in the conduct of our business and that the loss thereof is not adverse in any material respect to the holders of the debt securities; and

- pay, and cause our significant subsidiaries to pay, our and their taxes, assessments and government levies when due, except to the extent the same is being contested in good faith by appropriate proceedings.

Covenants in the Senior Indenture

You can find the definitions of certain terms used in this description under the subheading Certain Definitions.

Limitation on Secured Debt

Unless otherwise provided in the applicable prospectus supplement and/or free writing prospectus, we will not, and will not permit any Subsidiary to, create, assume, or guarantee any Secured Debt without making effective provision for securing the senior debt securities equally and ratably with such Secured Debt. This covenant does not apply to debt secured by:

- purchase money mortgages created to secure payment for the acquisition or construction of any property including, but not limited to, any indebtedness incurred by us or a Subsidiary prior to, at the time of, or within 180 days after the later of the acquisition, the completion of construction (including any improvements on an existing property) or the commencement of commercial operation of such property, which indebtedness is incurred for the purpose of financing all or any part of the purchase price of such property or construction or improvements on such property;

- mortgages, pledges, liens, security interest or encumbrances (collectively referred to as security interests) on property, or any conditional sales agreement or any title retention with respect to property, existing at the time of acquisition thereof, whether or not assumed by us or a Subsidiary;

- security interests on property or shares of capital stock or indebtedness of any corporation or firm existing at the time such corporation or firm becomes a Subsidiary;

- security interests in property or shares of capital stock or indebtedness of a corporation existing at the time such corporation is merged into or consolidated with us or a Subsidiary or at the time of a sale, lease, or other disposition of the properties of a corporation or firm as an entirety or substantially as an entirety to us or a Subsidiary, provided that no such security interests shall extend to any other Principal Property of ours or such Subsidiary prior to such acquisition or to other Principal Property thereafter acquired other than additions or improvements to the acquired property;

security interests on our property or property of a Subsidiary in favor of the United States of America or any state thereof, or in favor of any other country, or any department, agency, instrumentality or political subdivision thereof (including, without limitation, security interests to secure indebtedness of the pollution control or industrial revenue type) in order to permit us or any Subsidiary to perform a contract or to secure indebtedness incurred for the purpose of financing all or any part of the purchase price for the cost of constructing or improving the property subject to such security interests or which is required by law or regulation as a condition to the transaction of any business or the exercise of any privilege, franchise or license;

security interests on any property or assets of any Subsidiary to secure indebtedness owing by it to us or to another Subsidiary;

any mechanics , materialmen s, carriers or other similar lien arising in the ordinary course of business, including construction of facilities, in respect of obligations which are not yet due or which are being contested in good faith;

any security interest for taxes, assessments or government charges or levies not yet delinquent, or already delinquent, but the validity of which is being contested in good faith;

any security interest arising in connection with legal proceedings being contested in good faith, including any judgment lien so long as execution thereof is being stayed;

landlords liens on fixtures located on premises leased by us or a Subsidiary in the ordinary course of business; or

any extension, renewal or replacement, or successive extensions, renewals or replacements, in whole or in part, of any security interest referred to in the foregoing bullets.

Limitation on Sale and Leaseback Transactions

Unless otherwise provided in the applicable prospectus supplement and/or free writing prospectus, the senior indenture provides that we will not, and will not permit any Subsidiary to, enter any lease longer than three years (excluding leases of newly acquired, improved or constructed property) covering any Principal Property of ours or any Subsidiary that is sold to any other person in connection with such lease (a Sale and Leaseback Transaction), unless either:

we or such Subsidiary would be entitled, without equally and ratably securing the senior debt securities, to incur Indebtedness secured by a mortgage on the Principal Property leased pursuant to any of the bullets referenced above under Limitation on Secured Debt, or

an amount equal to the value of the Principal Property so leased is applied to the retirement, within 120 days of the effective date of such arrangement, of indebtedness for borrowed money incurred or assumed by us or a Subsidiary which is recorded as Funded Debt as shown on our most recent consolidated balance sheet and which in the case of such Indebtedness of ours, is not subordinate and junior in right of payment to the prior payment of the senior debt securities.

Exempted Indebtedness

Notwithstanding the limitations on Secured Debt and Sale and Leaseback Transactions described above, we and any one or more Subsidiaries may, without securing the senior debt securities, issue, assume, or guarantee Secured Debt or enter into any Sale and Leaseback Transaction which would otherwise be subject to the foregoing restrictions, provided that, after giving effect thereto, the aggregate amount of such Secured Debt then outstanding (not including Secured Debt permitted under the foregoing exceptions) and the Attributable Debt of Sale and Leaseback Transactions, other than Sale and Leaseback Transactions described in either bullet of the preceding paragraph, at such time does not exceed 15% of Consolidated Net Assets.

Certain Definitions

Set forth below are certain defined terms used in the senior indenture. Reference is made to the senior indenture for a complete definition of these terms, as well as any other capitalized terms used herein for which no definition is provided. Unless otherwise provided in the applicable prospectus supplement, the following terms will mean as follows for purposes of covenants that may be applicable to any particular series of senior debt securities.

The term Attributable Debt, in respect of a Sale and Leaseback Transaction, means, as of any particular time, the present value (discounted at the rate of interest implicit in the lease involved in such Sale and Leaseback Transaction, as determined in good faith by us) of the obligation of the lessee thereunder for rental payments (excluding, however, any amounts required to be paid by such lessee, whether or not designated as rent or additional rent, on account of maintenance and repairs, insurance, taxes, assessments, water rates or similar charges or any amounts required to be paid by such lessee thereunder contingent upon the amount of sales, maintenance and repairs, insurance, taxes, assessments, water rates or similar charges) during the remaining term of such lease (including any period for which such lease has been extended or may, at the option of the lessor, be extended).

The term Consolidated Assets means the aggregate of all assets of us and our Subsidiaries (including the value of all existing Sale and Leaseback Transactions and any assets resulting from the capitalization of other long-term lease obligations in accordance with generally accepted accounting principles in the United States (GAAP)), appearing on the most recent available consolidated balance sheet of us and our Subsidiaries at their net book values, after deducting related depreciation, amortization and other valuation reserves, all prepared in accordance with GAAP.

The term Consolidated Current Liabilities means the aggregate of the current liabilities of us and our Subsidiaries appearing on the most recent available consolidated balance sheet of us and our Subsidiaries, all in accordance with GAAP. In no event shall Consolidated Current Liabilities include any obligation of us and our Subsidiaries issued under a revolving credit or similar agreement if the obligation issued under such agreement matures by its terms within twelve months from the date thereof but by the terms of such agreement such obligation may be renewed or extended or the amount thereof reborrowed or refunded at our option or the option of any Subsidiary for a term in excess of twelve months from the date of determination.

The term Consolidated Net Assets means Consolidated Assets after deduction of Consolidated Current Liabilities.

The term Funded Debt means all indebtedness for money borrowed having a maturity of more than twelve months from the date of the most recent consolidated balance sheet of us and our Subsidiaries or renewable and extendable beyond twelve months at the option of the borrower and all obligations in respect of lease rentals which under GAAP would be shown on our consolidated balance sheet as a liability item other than a current liability; provided, however, that Funded Debt shall not include any of the foregoing to the extent that such indebtedness or obligations are not required by GAAP to be shown on our balance sheet.

The term Principal Property means any manufacturing plant, warehouse, office building or parcel of real property (including fixtures but excluding leases and other contract rights which might otherwise be deemed real property) owned by us or any Subsidiary, whether owned on the date of the indenture or thereafter, provided each such plant, warehouse, office building or parcel of real property has a gross book value (without deduction for any depreciation reserves) at the date as of which the determination is being made of in excess of two percent of the Consolidated Net Assets of us and our Subsidiaries, other than any such plant, warehouse, office building or parcel of real property or portion thereof which, in the opinion of our board of directors (evidenced by a certified board resolution delivered to the trustee), is not of material importance to the business conducted by us and our Subsidiaries taken as a whole.

The term Secured Debt means Indebtedness for borrowed money and any Funded Debt which, in each case, is secured by a security interest in:

- any Principal Property, or
- any shares of capital stock or Indebtedness of any Subsidiary.

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The term Subsidiary means any corporation or other entity (including, without limitation, partnerships, joint ventures and associations) of which at least a majority of the outstanding stock having by the terms thereof ordinary voting power for the election of directors of such corporation or other entity (irrespective of whether or not at the time the stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any such contingency) is at the time directly or indirectly owned by Danaher, or by one or more Subsidiaries of Danaher, or by Danaher and one or more other Subsidiaries.

Consolidation, Merger and Sale of Assets

Unless otherwise provided in the applicable prospectus supplement, our indentures prohibit us from consolidating with or merging into another business entity, or conveying, transferring or leasing our properties and assets substantially as an entirety to any business entity, unless:

- the surviving or acquiring entity is a U.S. corporation, limited liability company, partnership or trust, and it expressly assumes our obligations with respect to outstanding debt securities by executing a supplemental indenture;

- immediately after giving effect to the transaction, no event of default, or event which, after notice or lapse of time or both, would become an event of default, shall have happened and be continuing; and

- we have delivered to the trustee an officers certificate and an opinion of counsel, each stating that the consolidation, merger, conveyance, transfer or lease and, if a supplemental indenture is required in connection with such transaction, such supplemental indenture, comply with the indenture and all conditions precedent relating to such transaction have been complied with.

Conversion Rights

We will describe the terms upon which debt securities may be convertible into our common stock or other securities in a prospectus supplement. These terms will include the type of securities the debt securities are convertible into, the conversion price or manner of calculation thereof, the conversion period, provisions as to whether conversion will be at our option or the option of the holders, the events requiring an adjustment of the conversion price and provisions affecting conversion in the event of the redemption of the debt securities and any restrictions on conversion. They may also include provisions adjusting the number of shares of our common stock or other securities issuable upon conversion.

Denomination

Normally, we will denominate and make payments on debt securities in U.S. dollars. If we issue debt securities denominated, or with payments, in a foreign or composite currency, a prospectus supplement will specify the currency or composite currency. Except as may be provided otherwise in the applicable prospectus supplement and/or free writing prospectus, we will issue registered securities in denominations of $1,000 or integral multiples of $1,000.

Our Debt Trustee

Unless stated in the applicable prospectus supplement, (i) the trustee may also be the trustee under any other indenture for debt securities and (ii) any trustee or its affiliates may lend money to us and/or may from time to time have other business arrangements with us. If and when the trustee becomes a creditor of ours, the trustee will be subject to the provisions of the Trust Indenture Act regarding the collection of claims against us.

Governing Law

The indentures and the debt securities will be governed by the laws of the State of New York.

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DESCRIPTION OF CAPITAL STOCK

General

The following summary description of our capital stock is based on the provisions of the Delaware General Corporation Law (the DGCL) and our certificate of incorporation and bylaws, as amended and restated through the date of this prospectus. This description does not purport to be complete and is qualified in its entirety by reference to the terms of the restated certificate of incorporation and bylaws. See Where You Can Find More Information.

Our authorized capital stock consists of 1,000,000,000 shares of common stock, par value $0.01 per share, and 15,000,000 shares of preferred stock, without par value. As of May 5, 2009, we had 318,704,681 shares of our common stock outstanding and no shares of preferred stock outstanding.

Common Stock

Each stockholder of record of our common stock is entitled to one vote for each share held on every matter properly submitted to the stockholders for their vote, including the election of directors. Holders of our common stock do not have cumulative voting rights. After satisfaction of the dividend rights of holders of preferred stock, holders of common stock are entitled ratably to any dividend declared by the board of directors out of funds legally available for this purpose. Upon our liquidation, dissolution or winding up, the holders of our common stock are entitled to receive ratably our net assets available, if any, after the payment of all debts and other liabilities and subject to the prior rights of any outstanding preferred stock. Holders of our common stock have no redemption or conversion rights, no sinking fund provisions and no preemptive right to subscribe for or purchase additional shares of any class of our capital stock. The outstanding shares of our common stock are fully paid and nonassessable, and any shares of common stock issued in an offering pursuant to this prospectus and any shares of common stock issuable upon the exercise of common stock warrants or conversion or exchange of debt securities which are convertible into or exchangeable for our common stock, or in connection with the obligations of a holder of purchase contracts to purchase our common stock, when issued in accordance with their terms will be fully paid and nonassessable. The rights, preferences and privileges of holders of common stock are subject to, and may be adversely affected by, the rights of the holders of shares of any series of preferred stock that we may designate and issue in the future.

Preferred Stock

This section describes the general terms and provisions of our preferred stock. The applicable prospectus supplement will describe the specific terms of the shares of preferred stock offered through that prospectus supplement, as well as any general terms described in this section that will not apply to those shares of preferred stock. We will file a copy of the certificate of designation that contains the terms of each new series of preferred stock with the SEC each time we issue a new series of preferred stock. Each certificate of designation will establish the number of shares included in a designated series and fix the designation, powers, privileges, preferences and rights of the shares of each series as well as any applicable qualifications, limitations or restrictions. You should refer to the applicable certificate of designation as well as our restated certificate of incorporation before deciding to buy shares of our preferred stock as described in the applicable prospectus supplement.

Our board of directors has been authorized to provide for the issuance of up to 15,000,000 shares of our preferred stock in multiple series without the approval of stockholders. With respect to each series of our preferred stock, our board of directors has the authority to fix the following terms:

- the designation of the series;
- the number of shares within the series;
- whether dividends are cumulative and, if cumulative, the dates from which dividends are cumulative;

the rate of any dividends, any conditions upon which dividends are payable, and the dates of payment of dividends;

whether interests in the shares of preferred stock will be represented by depositary shares as more fully described below under Description of Depositary Shares ;

whether the shares are redeemable, the redemption price and the terms of redemption;

the amount payable to you for each share you own if we dissolve or liquidate;

whether the shares are convertible or exchangeable, the price or rate of conversion or exchange, and the applicable terms and conditions;

any restrictions on issuance of shares in the same series or any other series;

voting rights applicable to the series of preferred stock; and

any other rights, priorities, preferences, restrictions or limitations of such series.

Your rights with respect to your shares of preferred stock will be subordinate to the rights of our general creditors. Shares of our preferred stock that we issue in accordance with their terms will be fully paid and nonassessable, and will not be entitled to preemptive rights unless specified in the applicable prospectus supplement.

Our ability to issue preferred stock, or rights to purchase such shares, could discourage an unsolicited acquisition proposal. For example, we could impede a business combination by issuing a series of preferred stock containing class voting rights that would enable the holders of such preferred stock to block a business combination transaction. Alternatively, we could facilitate a business combination transaction by issuing a series of preferred stock having sufficient voting rights to provide a required percentage vote of the stockholders. Additionally, under certain circumstances, our issuance of preferred stock could adversely affect the voting power of the holders of our common stock. Although our board of directors is required to make any determination to issue any preferred stock based on its judgment as to the best interests of our stockholders, our board of directors could act in a manner that would discourage an acquisition attempt or other transaction that some, or a majority, of our stockholders might believe to be in their best interests or in which stockholders might receive a premium for their stock over prevailing market prices of such stock. Our board of directors does not at present intend to seek stockholder approval prior to any issuance of currently authorized stock, unless otherwise required by law or applicable stock exchange requirements.

Limitation on Directors Liability

Our restated certificate of incorporation provides, as authorized by Section 102(b)(7) of the DGCL, that our directors will not be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director, except for liability:

for any breach of the director s duty of loyalty to us or our stockholders;

for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;

for unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the DGCL; or for any transaction from which the director derived an improper personal benefit.

The inclusion of this provision in our restated certificate of incorporation may have the effect of reducing the likelihood of derivative litigation against directors, and may discourage or deter stockholders or management from bringing a lawsuit against directors for breach of their duty of care, even though such an action, if successful, might otherwise have benefited us and our stockholders.

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Section 203 of the Delaware General Corporation Law

Section 203 of the DGCL prohibits a defined set of transactions between a Delaware corporation, such as us, and an interested stockholder. An interested stockholder is defined as a person who, together with any affiliates or associates of such person, beneficially owns, directly or indirectly, 15% or more of the outstanding voting shares of a Delaware corporation. This provision may prohibit business combinations between an interested stockholder and a corporation for a period of three years after the date the interested stockholder becomes an interested stockholder. The term business combination is broadly defined to include mergers, consolidations, sales or other dispositions of assets having a total value in excess of 10% of the consolidated assets of the corporation, and some other transactions that would increase the interested stockholder s proportionate share ownership in the corporation.

This prohibition is effective unless:

- the business combination is approved by the corporation s board of directors prior to the time the interested stockholder becomes an interested stockholder;

- the interested stockholder acquired at least 85% of the voting stock of the corporation, other than stock held by directors who are also officers or by qualified employee stock plans, in the transaction in which it becomes an interested stockholder; or

- the business combination is approved by a majority of the board of directors and by the affirmative vote of two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

In general, the prohibitions do not apply to business combinations with persons who were stockholders before we became subject to Section 203.

Advance Notice Bylaw Provisions

Our bylaws establish advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors, other than proposals and nominations made by or at the direction of the board of directors.

Special Charter Provisions

Our restated certificate of incorporation divides our board of directors into three classes of directors serving staggered, three-year terms. Vacancies, and newly-created directorships resulting from any increase in the size of our board, may be filled by our board, even if the directors then on the board do not constitute a quorum or only one director is left in office. These provisions, together with the provisions of Section 203 of the DGCL, could have the effect of delaying, deferring or preventing a change in control or the removal of existing management, of deterring potential acquirors from making an offer to our stockholders and of limiting any opportunity to realize premiums over prevailing market prices for our common stock in connection therewith. This could be the case notwithstanding that a majority of our stockholders might benefit from such a change in control or offer.

Transfer Agent and Registrar

Computershare Investor Services, LLC serves as the registrar and transfer agent for the common stock.

Stock Exchange Listing

Our common stock is listed on the New York Stock Exchange under the trading symbol DHR .

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DESCRIPTION OF WARRANTS

General

We may issue warrants to purchase our debt or equity securities. We may issue warrants independently or together with any offered securities and the warrants may be attached to or separate from those offered securities. We will issue the warrants under warrant agreements to be entered into between us and a bank or trust company, as warrant agent, all as described in the applicable prospectus supplement. The warrant agent will act solely as our agent in connection with the warrants of the series being offered and will not assume any obligation or relationship of agency or trust for or with any holders or beneficial owners of warrants.

The applicable prospectus supplement will describe the following terms, where applicable, of warrants in respect of which this prospectus is being delivered:

- the title of the warrants;
- the designation, amount and terms of the securities for which the warrants are exercisable;
- the designation and terms of the other securities, if any, with which the warrants are to be issued and the number of warrants issued with each such security;
- the price or prices at which the warrants will be issued;
- the aggregate number of warrants;
- any provisions for adjustment of the number or amount of securities receivable upon exercise of the warrants or the exercise price of the warrants;
- the price or prices at which the securities purchasable upon exercise of the warrants may be purchased;
- if applicable, the date on and after which the warrants and the securities purchasable upon exercise of the warrants will be separately transferable;
- if applicable, a discussion of the material United States federal income tax considerations applicable to the exercise of the warrants;
- any other terms of the warrants, including terms, procedures and limitations relating to the exchange and exercise of the warrants;
- the date on which the right to exercise the warrants shall commence, and the date on which the right shall expire;
- the currency or currencies in which the warrants are exercisable;

the terms of any mandatory or optional redemption or call provisions;

the identity of the warrant agent;

if applicable, the maximum or minimum number of warrants which may be exercised at any time; and

information with respect to book-entry procedures, if any.

Exercise of Warrants

Each warrant will entitle the holder of warrants to purchase for cash the amount of debt or equity securities, at the exercise price as shall be set forth in, or be determinable as set forth in, the prospectus supplement relating to the warrants. Warrants may be exercised at any time up to the close of business on the expiration date set forth in the prospectus supplement relating to the warrants. After the close of business on the expiration date, unexercised warrants will become void.

Warrants may be exercised as set forth in the prospectus supplement relating to the warrants. When the warrant holder makes the payment and properly completes and signs the warrant certificate at the corporate trust office of the warrant agent or any other office indicated in the prospectus supplement, we will, as soon as possible, forward the debt or equity securities which the warrant holder has purchased. If the warrant holder exercises the warrant for less than all of the warrants represented by the warrant certificates, we will issue a new warrant certificate for the remaining warrants.

Until the exercise of their warrants for debt or equity securities, holders of warrants will not have rights as a holder of the debt or equity securities, as the case may be, by virtue of such holder s ownership of warrants.

DESCRIPTION OF DEPOSITARY SHARES

General

We may offer fractional shares of preferred stock, rather than full shares of preferred stock. If we do so, we may issue receipts for depositary shares that each represent a fraction of a share of a particular series of preferred stock. The prospectus supplement will indicate that fraction. The shares of preferred stock represented by depositary shares will be deposited under a depositary agreement between us and a bank or trust company that meets certain requirements and is selected by us (the Bank Depositary). Each owner of a depositary share will be entitled to all the rights and preferences of the preferred stock represented by the depositary share. The depositary shares will be evidenced by depositary receipts issued pursuant to the depositary agreement. Depositary receipts will be distributed to those persons purchasing the fractional shares of preferred stock in accordance with the terms of the offering.

We have summarized some common provisions of a depositary agreement and the related depositary receipts. The forms of the depositary agreement and the depositary receipts relating to any particular issue of depositary shares will be filed with the SEC each time we issue depositary shares, and you should read those documents for provisions that may be important to you. The applicable prospectus supplement will describe the terms of any depositary shares.

Dividends and Other Distributions

If we pay a cash distribution or dividend on a series of preferred stock represented by depositary shares, the Bank Depositary will distribute such dividends to the record holders of such depositary shares. If the distributions are in property other than cash, the Bank Depositary will distribute the property to the record holders of the depositary shares. However, if the Bank Depositary determines that it is not feasible to make the distribution of property, the Bank Depositary may, with our approval, sell such property and distribute the net proceeds from such sale to the record holders of the depositary shares.

Redemption of Depositary Shares

If we redeem a series of preferred stock represented by depositary shares, the Bank Depositary will redeem the depositary shares from the proceeds received by the Bank Depositary in connection with the redemption. The redemption price per depositary share will equal the applicable fraction of the redemption price per share of the preferred stock. If fewer than all the depositary shares are redeemed, the depositary shares to be redeemed will be selected by lot or pro rata as the Bank Depositary may determine.

Voting the Preferred Stock

Upon receipt of notice of any meeting at which the holders of the preferred stock represented by depositary shares are entitled to vote, the Bank Depositary will mail the notice to the record holders of the depositary shares relating to such preferred stock. Each record holder of these depositary shares on the record date, which will be the same date as the record date for the preferred stock, may instruct the Bank Depositary as to how to vote the preferred stock represented by such holder s depositary shares. The Bank Depositary will endeavor, insofar as

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practicable, to vote the amount of the preferred stock represented by such depositary shares in accordance with such instructions, and we will take all action which the Bank Depositary deems necessary in order to enable the Bank Depositary to do so. The Bank Depositary will abstain from voting shares of the preferred stock to the extent it does not receive specific instructions from the holders of depositary shares representing such preferred stock.

Amendment and Termination of the Depositary Agreement

The form of depositary receipt evidencing the depositary shares and any provision of the depositary agreement may be amended by agreement between the Bank Depositary and us. However, any amendment that materially and adversely alters the rights of the holders of depositary shares will not be effective unless such amendment has been approved by the holders of at least a majority of the depositary shares then outstanding. The depositary agreement may be terminated by the Bank Depositary or us only if (1) all outstanding depositary shares have been redeemed or (2) there has been a final distribution in respect of the preferred stock in connection with any liquidation, dissolution or winding up of our company and such distribution has been distributed to the holders of depositary receipts.

Charges of Bank Depositary

We will pay all transfer and other taxes and governmental charges arising solely from the existence of the depositary arrangements. We will pay charges of the Bank Depositary in connection with the initial deposit of the preferred stock and any redemption of the preferred stock. Holders of depositary receipts will pay other transfer and other taxes and governmental charges and any other charges, including a fee for the withdrawal of shares of preferred stock upon surrender of depositary receipts, as are expressly provided in the depositary agreement to be for their accounts.

Withdrawal of Preferred Stock

1,814 664 173 677 168

Tax (charge)/credit attributable to shareholders returns

(309) 23 n/a 43 n/a

Profit for the period attributable to shareholders

1,505 687 119 720 109

* Following its sale in May 2017, the operating results exclude the contribution of the Korea life business. All comparative results have been similarly adjusted.

Notes

(i) The Group provides supplementary analysis of IFRS profit before tax attributable to shareholders so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. Operating profit based on longer-term investment returns is the basis on which management regularly reviews the performance of Prudential s segments as defined by IFRS 8. Further discussion on the determination of operating profit based on longer-term investment returns is provided in section (c) Additional explanation of performance measures and analysis of consolidated results by business segment and geographical region above.

(ii) The results of Prudential s long-term business operations are affected by changes to assumptions, estimates and bases of preparation. Where applicable, these are described in note B4 to the unaudited condensed consolidated interim financial statements.

(iii) General insurance commission represents the commission receivable net of expenses for Prudential-branded general insurance products in connection with the arrangement to transfer the UK general insurance business to Churchill in 2002.

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(iv) Short-term fluctuations in investment returns on shareholder-backed business comprise:

	Actual Exchange Rate	
	2017 £m Half year	**2016 £m Half year**
Insurance operations:		
Asia	**41**	1
US	**(754)**	(1,440)
UK	**9**	246
Other operations	**131**	(192)
Total	**(573)**	(1,385)

Further details on the short-term fluctuations in investment returns are provided below and in note B1.2 to the unaudited condensed consolidated interim financial statements.

Earnings per share (EPS)

	Actual Exchange Rate			Constant Exchange Rate	
	2017 pence Half year	**2016 pence Half year**	**Change%**	**2016 pence Half year**	**Change%**
Basic earnings per share based on operating profit after tax	**70.0**	61.3	14	67.6	4
Basic earnings per share based on total profit after tax	**58.7**	26.9	118	28.2	108

Prudential has made a good start to 2017, with increases in all of our key performance metrics, reflecting progression in the Group s underlying earnings drivers together with the beneficial impact of positive investment market conditions and favourable currency effects. The consistency of our performance is driven by the alignment of our business to the most attractive opportunities, the quality of our franchises in those markets and our ability to adapt with speed and agility to changes in economic and regulatory conditions, both globally and locally. At a Group level, our results benefit from diversification by geography, product and distribution channel, our focus on recurring income streams that are less exposed to market movements and the capital generative nature of our business model.

In Asia, we have achieved double-digit growth in IFRS operating profit, reflecting the increasing scale and diversification of our long-term recurring premium business. We continue to take decisive actions to preserve the quality of the business that we write, building the contribution from health and protection income and improving the overall economic returns of the new business portfolio.

In the US and the UK, our financial progress is underpinned by the accumulation of assets on which we earn fees. In each of these markets, our businesses have seen strong net inflows in the first half, demonstrating their competitive positioning in product, distribution and service capabilities. Asset values were also boosted by positive investment market movements in the period.

Despite the uncertainty caused by the outcome of the general election in the UK, sterling has strengthened slightly against most of the currencies in our major international markets since the beginning of the year. However, average sterling exchange rates in the first half of 2017 were significantly lower than in the same period in 2016, contributing to a positive effect on the translation of results from our non-sterling operations. To aid comparison of underlying progress, we continue to express and comment on the performance trends of our Asia and US operations on a constant currency basis, as discussed further below.

Consistent with the explanations made in the currency volatility section in the Summary of Operating and Financial Review and Prospects comparison of the half year 2017 and half year 2016 performance is partially affected by the movements in average exchange rates used to translate into sterling the results of our overseas operations. Therefore, to facilitate explanations of changes in underlying performance, in the commentary on half year 2017 compared with half year 2016 discussions below, every time we comment on the performance of our businesses, we focus on their performance measured on the constant exchange rates basis unless otherwise stated. In each such case, the performance of our businesses in actual exchange rate terms was explained by the same factors discussed in the comments below and the impact of currency movements implicit in the constant exchange rate data.

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The key operational highlights in the first half of 2017 were as follows:

Operating profit based on longer-term investment returns was 5 per cent[1] higher at £2,358 million (up 15 per cent on an actual exchange rate basis), equivalent to an annualised 24 per cent[2] return on opening IFRS shareholders funds. The Group s performance was driven by our Asia life and asset management operations which saw IFRS operating profit increase 16 per cent[1] to £953 million on growth in the in-force portfolio (31 per cent on an actual exchange rate basis). In the US, total IFRS operating profit was up 8 per cent, driven by increased levels of fee income on higher separate account balances (22 per cent increase on an actual exchange rate basis). In the UK, IFRS operating profit from our insurance and asset management operations increased by 4 per cent[3], due to stronger contributions from management actions in the life business and higher assets under management at M&G.

Group shareholders Solvency II capital surplus was estimated at £12.9 billion[4,5] at 30 June 2017, equivalent to a cover ratio of 202 per cent (31 December 2016: £12.5 billion, 201 per cent). The movement since the start of the year primarily reflects the Group s continuing strong operating capital generation, partially offset by the payment of the 2016 second interim dividend.

Investment markets have been generally supportive through the period, with equity markets trending upwards and more stability in bond and currency markets compared with 2016. The recovery in equity markets towards the end of 2016 has continued into 2017, with the S&P 500 index up 8 per cent and the FTSE 100 index gaining 2 per cent in the first six months. Longer-term yields at 30 June 2017 were almost unchanged from those at the start of the year in the UK and down slightly in the US. In Asia, where yield movements have been more pronounced, our operating earnings are largely insensitive to interest rates. Overall, we continue to reduce the sensitivity of our earnings and balance sheet to investment markets, but remain significant long-term holders of financial assets to back the commitments that we have made to our customers. Short-term fluctuations in both these assets and related liabilities are reported outside the operating result, which is based on longer-term investment return assumptions. In the first half of 2017, these short-term fluctuations were overall negative, driven by the effect of higher equity markets on our hedging programme in the US. In the first half of the year total IFRS post tax profit was up at £1,505 million (2016: £720 million on a constant exchange rate basis and £687 million on an actual exchange rate basis).

Reflecting the strong operating results, the Group s IFRS shareholders equity increased by 5 per cent[6] over the six month period to £15.4 billion (31 December 2016: £14.7 billion).

Operating profit based on longer-term investment returns

Total operating profit increased by 5 per cent[1] (15 per cent on an actual exchange rate basis) in the first half of 2017 to £2,358 million.

Asia total operating profit of £953 million was 16 per cent[1] higher (31 per cent on an actual exchange rate basis), with continued strong growth in both life insurance and asset management through Eastspring.

US total operating profit at £1,073 million increased by 8 per cent (22 per cent increase on an actual exchange rate basis), reflecting increased levels of fee income on higher variable annuity account balances.

UK total operating profit of £497 million was in line with the first half of 2016, with lower shareholder annuity profits offset by larger contributions from management actions.

M&G operating profit was 10 per cent higher at £248 million, driven by increased funds under management as a result of asset inflows and positive markets.

Life insurance operations: Taken together, operating profit based on longer-term investment returns from our life insurance operations in Asia, the US and the UK increased 9 per cent[1] to £2,429 million (20 per cent on an actual exchange rate basis).

Operating profit based on longer-term investment returns in our life insurance operations in **Asia** was 16 per cent[1] higher at £870 million (up 30 per cent on an actual exchange rate basis), as a result of the continued growth of our in-force book of recurring premium business. Insurance margin was 24 per cent higher (39 per cent on an actual exchange rate basis) and accounted for 69 per cent of operating income[7], reflecting our ongoing preference for

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health and protection. Following strong recent growth in sales volumes, particularly in health and protection through our agency channel, the contribution to IFRS operating profit based on longer-term investment returns from China and Hong Kong combined has become more significant to the overall total, accounting for 23 per cent compared with 17 per cent one year ago. IFRS operating profit from Indonesia was 5 per cent higher (up 20 per cent on an actual exchange rate basis) and on the same basis Singapore was 6 per cent higher (up 20 per cent on an actual exchange rate basis).

In the **US**, life operating profit based on longer-term investment returns was up 7 per cent at £1,079 million (up 22 per cent on an actual exchange rate basis), reflecting increased profits from our variable annuity business. US equity markets rallied towards the end of 2016 and have risen further during the first half of 2017, which together with continued positive net asset flows of £2.0 billion, has led to separate account balances that were on average 16 per cent higher than in the prior year period. As a result, fee income was up 15 per cent (30 per cent on an actual exchange rate basis) at £1,145 million driven by fees earned on separate account assets. Spread-based income decreased by 6 per cent (6 per cent on an actual exchange rate basis), as anticipated, reflecting the impact of lower yields on our fixed annuity portfolio.

UK life operating profit based on longer-term investment returns increased by 1 per cent to £480 million. Within this total, the contribution from our core in-force book has remained relatively stable at £288 million (2016: £306 million). Profits from new annuity business reduced to £4 million from £27 million in the prior period, reflecting our withdrawal from this market. We have taken a number of asset and liability actions (including longevity reinsurance) in the first half of 2017 to improve portfolio efficiency which have generated combined profits of £188 million (2016: £140 million).

The increase in our operating earnings levels reflects the growth in the scale of our operations, driven primarily by positive business flows. We track the progress that we make in growing our life insurance business by reference to the scale of our obligations to our customers, which are referred to in the financial statements as policyholder liabilities. Each period these increase as we write new business and collect regular premiums from existing customers and decrease as we pay claims and policies mature. The overall scale of these policyholder liabilities is relevant in evaluation of our profit potential in that it reflects, for example, our ability to earn fees on the unit-linked element and indicates the scale of the insurance element, another key source of profitability for the Group.

Shareholder-backed policyholder liabilities and net liability flows*

	2017 £m Half year Actual Exchange Rate				**2016 £m Half year Actual Exchange Rate**			
	At 1 January 2017	**Net liability flows****	**Market and other movements**	**At 30 June 2017**	**At 1 January 2016**	**Net liability flows****	**Market and other movements**	**At 30 June 2016**
Asia***	**32,851**	**1,016**	**1,173**	**35,040**	25,032	977	4,135	30,144
US	**177,626**	**1,958**	**(1,805)**	**177,779**	138,913	2,855	17,387	159,155
UK	**56,158**	**(1,167)**	**1,500**	**56,491**	52,824	(1,699)	4,286	55,411
Total Group	**266,635**	**1,807**	**868**	**269,310**	216,769	2,133	25,808	244,710

* Includes Group s proportionate share of the liabilities and associated flows of the insurance joint ventures and associate in Asia.

** Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.

*** Following its sale in May 2017, the shareholder-backed policyholder liabilities and related flows for Asia exclude the value for the Korea life business. The half year 2016 comparatives have been accordingly adjusted.

Focusing on the business supported by shareholder capital, which generates the majority of the life profit, in the first half of 2017 net flows into our businesses were overall positive at £1.8 billion. This was driven by our US and Asian operations, as we continue to focus on both retaining our existing customers and attracting new business to drive long-term value creation. The outflow from our UK operations primarily reflects the run-off of the in-force annuity portfolio following our withdrawal from selling new annuity business. This decrease in shareholder liabilities has been more than offset by the flows into the with-profit funds of £1.6 billion as shown in the table below. Positive investment markets in the first half have partly been offset by currency effects as sterling strengthened

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over the period, increasing liabilities by £0.9 billion. In total, business flows and market movements have increased policyholder liabilities from £266.3 billion to £269.3 billion.

Policyholder liabilities and net liability flows in with-profits business*,**

	2017 £m Half year Actual Exchange Rate				2016 £m Half year Actual Exchange Rate			
	At 1 January 2017	Net liability flows***	Market and other movements	At 30 June 2017	At 1 January 2016	Net liability flows***	Market and other movements	At 30 June 2016
Asia	**29,933**	**2,295**	**1,053**	**33,281**	20,934	1,551	4,355	26,840
UK	**113,146**	**1,574**	**3,729**	**118,449**	100,069	582	6,417	107,068
Total Group	**143,079**	**3,869**	**4,782**	**151,730**	121,003	2,133	10,772	133,908

* Includes Group s proportionate share of the liabilities and associated flows of the insurance joint ventures and associates in Asia.

** Includes unallocated surplus of with-profits business.

*** Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.

Policyholder liabilities in our with-profits business have increased by 6 per cent to £151.7 billion in the first half of 2017. This reflects the growing popularity of PruFund with consumers seeking protection from the impact of volatile market conditions. During the first half of 2017, net liability flows increased to £3.9 billion across our Asia and UK operations. As returns from these funds are smoothed and shared with customers, the emergence of shareholder profit is more gradual. The business, nevertheless, remains an important source of shareholder value.

Analysis of long-term insurance business pre-tax operating profit based on longer-term investment returns by driver*

	Actual Exchange Rate						Constant Exchange Rate		
	2017 £m Half year			2016 £m Half year			2016 £m Half year		
	Operating profit[1]	Average liability	Margin bps	Operating profit[1]	Average liability	Margin bps	Operating profit[1]	Average liability	Margin bps
Spread income	**583**	**89,314**	**131**	556	80,146	139	613	85,708	143
Fee income	**1,279**	**164,152**	**156**	989	129,054	153	1,118	143,526	156
With-profits	**172**	**132,701**	**26**	162	114,109	28	165	115,945	28
Insurance margin	**1,152**			898			1,013		
Margin on revenues	**1,138**			946			1,051		
Expenses:									
Acquisition costs**	**(1,241)**	**3,624**	**(34)%**	(1,027)	2,980	(34)%	(1,155)	3,296	(35)%
Administration expenses	**(1,131)**	**259,451**	**(87)**	(879)	216,075	(81)	(983)	236,974	(83)

DAC adjustments	**186**	132	149
Expected return on shareholder assets	**103**	111	124
	2,241	1,888	2,095
Longevity reinsurance and other management actions to improve solvency	**188**	140	140
Operating profit based on longer-term investment returns[1]	**2,429**	2,028	2,235

* For basis of preparation see note I (a) of Additional unaudited financial information.

** The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business. APE is defined under the section EEV Basis, New Business Results and Free Surplus Generation in this document.

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We continue to maintain our preference for higher-quality sources of income such as insurance margin and fee income. We favour insurance margin because it is relatively insensitive to the equity and interest rate cycle and prefer fee income to spread income because it is more capital-efficient. In line with this approach, on a constant exchange rate basis, in the first half of 2017, insurance margin has increased by 14 per cent[1] (up 28 per cent on an actual exchange rate basis) and fee income by 14 per cent[1] (up 29 per cent on an actual exchange rate basis), while spread income declined by 5 per cent[1] (up 5 per cent on an actual exchange rate basis). Administration expenses increased to £1,131 million[1] (2016: £983 million on a constant exchange rate basis and £879 million on an actual exchange rate basis) as the business continues to expand. The expense ratio has grown from 83 basis points to 87 basis points reflecting country mix and the continued increase in US producers selecting asset-based commissions which are treated as an administrative expense in this analysis.

Asset management

Movements in asset management operating profit are also primarily influenced by changes in the scale of these businesses, as measured by funds managed on behalf of external institutional and retail customers and our internal life insurance operations.

Asset management external funds under management*,**

	2017 £m Half year Actual Exchange Rate				**2016 £m Half year Actual Exchange Rate**			
	At 1 January 2017	**Net flows**	**Market and other movements**	**At 30 June 2017**	At 1 January 2016	Net flows	Market and other movements	At 30 June 2016
M&G	**136,763**	**7,179**	**5,176**	**149,118**	126,405	(6,966)	10,217	129,656
Eastspring[8]	**38,042**	**2,273**	**4,281**	**44,596**	30,281	(412)	2,859	32,728
Total asset management	**174,805**	**9,452**	**9,457**	**193,714**	156,686	(7,378)	13,076	162,384
Total asset management (including MMF)	**182,519**	**9,951**	**9,571**	**202,041**	**162,692**	**(6,722)**	**13,835**	**169,805**

* Includes Group s proportionate share in PPM South Africa and the Asia asset management joint ventures.

** For our asset management business the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(b) of the Additional unaudited financial information.

In the first half of 2017, average assets under management in our asset management businesses in the UK and Asia benefited from net inflows of assets and favourable markets, driving higher fee revenues. Reflecting this, IFRS operating profit from **M&G** increased by 10 per cent to £248 million and by 20 per cent at **Eastspring** (up 36 per cent on an actual exchange rate basis) to £83 million.

M&G s external assets under management have benefited from a strong recovery in net flows, reflecting improvements in investment performance and supportive markets. External net inflows totalled £7.2 billion (2016: net outflows of £7.0 billion), with strong contributions from European investors in the Optimal Income Fund, Global Floating High Yield Fund and multi-asset fund range, and from institutional clients investing in illiquid credit strategies. External assets under management at 30 June 2017 were £149.1 billion, up 9 per cent since the start of the year. Internal assets managed on behalf of Prudential s life operations also benefited from strong markets, rising 3 per cent and taking total assets under management to £281.5 billion (31 December 2016: £264.9 billion). Operating profit based on longer-term investment returns increased 10 per cent to £248 million, consistent with the year-on-year increase in average assets under management and reflecting a cost-income ratio of 53 per cent. M&G s full year cost-income ratio is typically higher than for the first half, as its cost base is weighted towards the second half of the year (Half year 2016: 52 per cent, Full year 2016: 59 percent).

Eastspring also attracted good levels of net inflows[8] in the first half across its equity, fixed income and balanced fund range, totalling £2.3 billion. Including money market funds and the assets managed for internal life operations, Eastspring s total assets under management increased to £130.5 billion (31 December 2016: £117.9 billion), while the cost-income ratio improved to 55 per cent (2016: 56 per cent), driving a 20 per cent (36 per cent on an actual exchange rate basis) increase in operating profit based on longer-term investment returns to £83 million (2016: £69 million on a constant exchange rate basis and £61 million on an actual exchange rate basis).

Net central expenditure

Higher interest costs related to the debt issued in 2016 contributed to an increase in net central expenditure of £77 million to £419 million (2016: £342 million).

Non-operating items

Non-operating items consist of short-term fluctuations in investment returns of negative £573 million (2016: £1,580 million on a constant exchange rate basis and £1,385 million on an actual exchange rate basis), the results attaching to the sold life business in Korea of £61 million (2016: £47 million on a constant exchange rate basis and £40 million on an actual exchange rate basis), and the amortisation of acquisition accounting adjustments of £32 million (2016: £39 million on a constant exchange rate basis and £35 million on an actual exchange rate basis) arising principally from the REALIC business in 2012. Following its disposal in the first half of 2017 the Result attaching to the sold Korea life business represents the recognition upon disposal in the income statement of cumulative foreign exchange gains previously recognised in other comprehensive income, which has no overall impact on shareholders equity. The 2016 comparative figure represents the profit before tax of the Korea life business in the first half of 2016.

Short-term fluctuations in investment returns represent the most significant component of non-operating items and are discussed further below.

Short-term fluctuations in investment returns

Operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns. In the first half of 2017 the total short-term fluctuations in investment returns relating to the life operations were negative £704 million, comprising positive £41 million for Asia, negative £754 million in the US and positive £9 million in the UK.

In the US, Jackson provides certain guarantees on its annuity products, the value of which would typically rise when equity markets fall and long-term interest rates decline. Jackson includes the expected cost of hedging when pricing its products and charges fees for these guarantees which are used as necessary, to purchase downside protection in the form of options and futures to mitigate the effect of equity market falls, and swaps and swaptions to cushion the impact of drops in long-term interest rates. Under IFRS, accounting for the movement in the valuation of these derivatives, which are all fair valued, is asymmetrical to the movement in guarantee liabilities, which are not fair valued in all cases. Jackson designs its hedge programme to protect the economics of the business from large movements in investment markets and accepts the variability in accounting results. The negative short-term fluctuations of £754 million in the first half are mainly attributable to the net value movement in the period of the hedge instruments held to manage market exposures primarily and reflect the positive equity market performance in the US during the period.

The positive short-term fluctuations in investment returns for other operations of £131 million (2016: negative £192 million) principally reflect unrealised value movements on financial instruments.

Effective tax rates

In the first half of 2017, the effective tax rate on operating profit based on longer-term investment returns was broadly in line with the equivalent rate last year at 24 per cent (2016: 23 per cent), with the difference being mainly due to the effect of prior year adjustments in the first half of 2017.

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The effective tax rate on the total IFRS profit was 17 per cent in the first half of 2017 (2016: negative 3 per cent), driven by the smaller negative short-term investment fluctuations in the US insurance operations, which attract tax relief at a higher rate than the rates at which profits are taxed elsewhere in the Group.

The main driver of the Group s effective tax rate is the mix of the profits between countries with higher tax rates (such as US, Indonesia and Malaysia), and countries with lower tax rates (such as Hong Kong, Singapore and the UK).

The proposed changes to the UK tax rules for utilisation of brought forward tax losses and the deductibility of interest are not expected to impact the Group s effective tax rate. No substantive US tax reform proposals which require material consideration have been issued as yet.

Total tax contribution

The Group continues to make significant tax contributions in the countries in which it operates, with £1,595 million remitted to tax authorities in the first half of 2017. This was higher than the equivalent amount of £1,293 million in the first half of 2016 due to an increase in corporation tax payments (up from £287 million to £535 million). This was principally because of increases in the US and UK, of which a significant proportion is an increase in the amount paid on profits taxable at policyholder rather than shareholder rate.

Publication of tax strategy

In the first half of 2017, the new UK requirement for large UK businesses to publish their tax strategy came into effect. Prudential s tax strategy, together with further details on tax payments made in 2016 have been made available on the Group s website.

Group and holding company cash flows

Prudential s consolidated cash flow includes the movement in cash included within both policyholders and shareholders funds, such as cash in the with-profits fund. Prudential therefore believes that it is more relevant to consider individual components of the movement in holding company cash flow which relate solely to the shareholders.

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient remittances are made to service central requirements (including paying the external dividend) and maximising value to shareholders through retention and reinvestment of capital in business opportunities.

Cash remitted to the corporate centre in the first half of 2017 totalled £1,230 million, 10 per cent higher than in 2016. Asia s net remittance was £350 million in the first half of 2017 (2016: £258 million), reflecting both business growth and the effect of weaker sterling. For similar reasons, Jackson s remittance also increased to £475 million in the first half of 2017, up from £339 million paid in the first half of 2016.The remittances from UK Life and M&G were broadly in line with the first half of 2016 at £215 million (2016: £ 215 million) and £175 million (2016: £150 million) respectively.

Cash remitted to the corporate centre in the first half of 2017 was used to meet central costs of £226 million (2016: £199 million) and pay the 2016 second interim ordinary dividend. Reflecting these and other movements in the period, total holding company cash at 30 June 2017 was £2,657 million compared with £2,626 million at the end of 2016.

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Capital position, financing and liquidity

Capital position

Analysis of movement in Group shareholder Solvency II surplus*

	2017 £bn	2016 £bn	
	Half year	Half year	Full year
Estimated solvency II surplus at 1 January	**12.5**	9.7	9.7
Operating experience	**1.7**	1.2	2.7
Non-operating experience (including market movements)	**-**	(2.4)	(1.1)
Other capital movements			
Subordinated debt issuance	**-**	0.7	1.2
Foreign currency translation impacts	**(0.5)**	0.9	1.6
Dividends paid	**(0.8)**	(0.9)	(1.3)
Methodology and calibration changes	**-**	(0.1)	(0.3)
Estimated Solvency II surplus at end of period	**12.9**	9.1	12.5

* The methodology and assumptions used in calculating the Solvency II capital results are set out in note II (b) of Additional unaudited financial information.

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in the Group s shareholders Solvency II capital surplus being estimated at £12.9 billion[4,5] at 30 June 2017 (equivalent to a solvency ratio of 202 per cent) compared with £12.5 billion (201 per cent) at 31 December 2016.

Prudential s designation as a Global Systemically Important Insurer (G-SII) was reaffirmed by the IAIS in November 2016, based on the updated methodology published in June 2016. Prudential is monitoring the development and potential impact of the policy measures and is continuing to engage with the PRA on the implications of the policy measures and Prudential s designation as a G-SII.

Local statutory capital

All of our subsidiaries continue to hold appropriate capital positions on a local regulatory basis. In the UK, at 30 June 2017, The Prudential Assurance Company Limited and its subsidiaries had an estimated Solvency II shareholder surplus of £5.3 billion[9] (equivalent to a solvency ratio of 168 per cent) and a with-profits surplus[10] of £4.1 billion (equivalent to a solvency ratio of 192 per cent).

Debt Portfolio

The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders exposure to credit is concentrated in the UK annuity portfolio and the US general account, mainly attributable to Jackson s fixed annuity portfolio. The credit exposure is well diversified and 98 per cent of our UK portfolio and 97 per cent of our US portfolio are investment grade. During the first half of 2017 there were no default losses in the US or the UK portfolio and reported impairments were minimal (2016: £32 million) in the US portfolio.

Financing and liquidity

Shareholders net core structural borrowings

	2017 £m	2016 £m	
	30-Jun	30-Jun	31-Dec
Total borrowings of shareholder-financed operations	**6,614**	5,966	6,798
Less: Holding company cash and short-term investments	**(2,657)**	(2,546)	(2,626)
Net core structural borrowings of shareholder-financed operations	**3,957**	3,420	4,172
Gearing ratio*	**20%**	22%	22%

* Net core structural borrowings as a proportion of IFRS shareholders funds plus net debt

Our financing and central liquidity position remained strong throughout the period. Our central cash resources amounted to £2.7 billion at 30 June 2017 (31 December 2016: £2.6 billion).

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In addition to its net core structural borrowings of shareholder-financed operations set out above, the Group also has access to funding via the money markets and has in place a global commercial paper programme. As at 30 June 2017, we had issued commercial paper under this programme totalling £10 million and US$1,058 million.

Prudential s holding company currently has access to £2.6 billion of syndicated and bilateral committed revolving credit facilities, provided by 19 major international banks, expiring between 2021 and 2022. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 30 June 2017. The medium-term note programme, the US shelf programme (platform for issuance of SEC registered public bonds in the US market), the commercial paper programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential s holding company and are intended to maintain a strong and flexible funding capacity.

Shareholders funds

The following table sets forth a summary of the movement in Prudential s IFRS shareholder funds:

	2017 £m	2016 £m	
	Half year	Half year	Full year
Profit after tax for the period	**1,505**	687	1,921
Exchange movements, net of related tax	**(224)**	806	1,161
Cumulative exchange gain of Korea life business recycled to profit and loss account	**(61)**	-	-
Unrealised gains and losses on Jackson securities classified as available for sale, net of related changes to deferred acquisition costs and tax	**300**	1,094	31
Dividends	**(786)**	(935)	(1,267)
Other	**49**	(2)	(135)
Net increase in shareholders funds	**783**	1,650	1,711
Shareholders funds at beginning of the period	**14,666**	12,955	12,955
Shareholders funds at end of the period	**15,449**	14,605	14,666
Shareholders value per share	**597p**	566p	568p
Return on Shareholders funds[2]	**24%**	24%	26%

Group IFRS shareholders funds at 30 June 2017 increased by 5 per cent to £15.4 billion (31 December 2016: £14.7 billion on an actual exchange rate basis), driven by the strength of the operating result, offset by dividend payments of £786 million representing the second interim dividend for 2016. In the first half of the period, UK sterling strengthened relative to the US dollar and various Asian currencies. With approximately 48 per cent of the Group IFRS net assets denominated in non-sterling currencies, this generated a negative exchange rate movement on net assets in the period. In addition, the fall in US long-term interest rates between the start and the end of the reporting period produced unrealised gains on fixed income securities held by Jackson accounted through other comprehensive income.

Corporate transactions

Entrance into Nigeria

In July 2017 the Group acquired a majority stake in Zenith Life of Nigeria and formed exclusive bancassurance partnerships with Zenith Bank in Nigeria and Ghana. The acquisition and bancassurance partnerships will see Prudential enter the market in Nigeria, Africa s largest economy, with a population of over 180 million. This demonstrates Prudential s commitment to Africa following the launch of businesses in Ghana and Kenya in 2014, in Uganda in 2015 and Zambia in 2016.

Disposal of Korea

In May 2017, the Group completed the sale of the Group s life Insurance subsidiary in Korea, PCA Life Insurance Co., Ltd to Mirae Asset Life Insurance Co., Ltd. for KRW170 billion (equivalent to £117 million at 17 May 2017 closing rate).

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Dividend

As in previous years, the first interim dividend for 2017 has been calculated formulaically as one third of the prior year s full year ordinary dividend. The Board has approved a first interim dividend for 2017 of 14.50 pence per share, which equates to an increase of 12 per cent over the 2016 first interim dividend.

The Group s dividend policy remains unchanged. The Board will maintain focus on delivering a growing ordinary dividend. In line with this policy, Prudential aims to grow the ordinary dividend by 5 per cent per annum. The potential for additional distributions will continue to be determined after taking into account the Group s financial flexibility across a broad range of financial metrics and an assessment of opportunities to generate attractive returns by investing in specific areas of the business.

Notes:

1. Following its sale in May 2017, the operating results exclude the contribution of the Korea life business. All comparative results have been similarly adjusted.
2. Annualised operating profit after tax and non-controlling interests as percentage of opening shareholders funds.
3. Includes UK life insurance and M&G.
4. Before allowing for first interim dividend.
5. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced With-Profit Funds and staff pension schemes in surplus. The solvency positions include management s estimate of transitional measures reflecting operating and market conditions at the valuation date. The estimated Group shareholder surplus would increase from £12.9 billion to £13.6 billion at 30 June 2017 if the approved regulatory transitional amount was applied instead.
6. Comparable to 31 December 2016 on an actual exchange rate basis.
7. Operating income comprises spread income, fee income, with-profits, insurance margin and expected shareholder return.
8. Net inflows exclude Asia Money Market Fund (MMF) inflows of £499 million (2016: net inflows £656 million on an actual exchange rate basis). External funds under management exclude Asia MMF balances of £8,327 million (2016: £7,421 million on an actual exchange rate basis).
9. The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced With-Profit Funds and staff pension schemes in surplus. The solvency positions include management s estimate of transitional measures reflecting operating and market conditions at the valuation date. The estimated UK shareholder surplus would increase from £5.3 billion to £6.0 billion at 30 June 2017 if the approved regulatory transitional amount was applied instead.
10. The UK with-profits Solvency II surplus includes the PAC with-profits sub-fund, the Scottish Amicable Insurance Fund and the Defined Charge Participating Sub-Fund. The estimated solvency position allows for management s estimate of transitional measures reflecting operating and market conditions at the valuation date.

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Explanation of Movements in Profits Before Shareholder Tax by Nature of Revenue and Charges

The following table shows Prudential s consolidated total revenue and consolidated total charges for the following periods.

	2017 £m Half year	2016 £m Half year
Earned premiums, net of reinsurance	**21,158**	17,394
Investment return	**20,629**	17,062
Other income	**1,222**	1,085
Total revenue, net of reinsurance	**43,009**	35,541
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance	**(35,442)**	(30,939)
Acquisition costs and other expenditure	**(5,330)**	(3,563)
Finance costs: interest on core structural borrowings of shareholder-financed operations	**(216)**	(169)
Disposal of Korea life business:		
Cumulative exchange gain recycled from other comprehensive income	**61**	-
Remeasurement adjustments	**5**	-
Total charges, net of reinsurance	**(40,922)**	(34,671)
Share of profits from joint ventures and associates, net of related tax	**120**	86
Profit before tax *(being tax attributable to shareholders and policyholders returns)**	**2,207**	956
Less tax charge attributable to policyholders returns	**(393)**	(292)
Profit before tax attributable to shareholders	**1,814**	664
Total tax charge attributable to policyholders and shareholders	**(702)**	(269)
Adjustment to remove tax charge attributable to policyholders returns	**393**	292
Tax (charge) credit attributable to shareholders returns	**(309)**	23
Profit for the period attributable to equity holders of the Company	**1,505**	687

* This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders. This is because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure (which is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the PAC with-profits fund after adjusting for taxes borne by policyholders) is not representative of pre-tax profits attributable to shareholders.

Earned premiums, net of reinsurance

	2017 £m Half year	2016 £m Half year
Asia operations	**7,454**	5,715
US operations	**7,829**	6,818
UK operations	**5,875**	4,861
Total	**21,158**	17,394

Earned premiums, net of reinsurance, for insurance operations totalled £21,158 million in half year 2017 compared to £17,394 million in half year 2016. The increase of £3,764 million for half year 2017 was driven by increases of

£1,739 million in the Asia operations, £1,011 million in the US operations and £1,014 million in the UK operations.

a) Asia

Earned premiums in Asia, net of reinsurance in half year 2017 were £7,454 million, an increase of 30 per cent compared to £5,715 million in half year 2016, on an actual exchange rate basis. Excluding the impact of exchange translation, earned premiums in Asia increased by 15 per cent compared to £6,473 million on a constant exchange rate basis in half year 2016.

The premiums reflect the aggregate of single and recurrent premiums of new business sold in the period and premiums on annual business sold in previous periods. The growth in earned premiums reflects increases for both factors.

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We continue to favour new business premiums that are long-term and recurring in nature and with a high proportion of health and protection, as these are characteristics that mean our income is less sensitive to market cyclicality and variability in economic conditions.

Sales increased in the first half of 2017, highlighting the consistency in performance from our broad and diversified new business franchise. As reported previously, the business took the decision in the first half of 2016 to pull back from the third-party broker channel in Hong Kong, which is reflected in a decline in sales in this market. Excluding the broker channel in Hong Kong, sales in Asia have increased, reflecting the improved performance in our agency and bancassurance channels.

We have continued to see strong demand for our products in China reflecting our efforts to grow health and protection sales through the agency channel. In Hong Kong, we are also increasing our focus on health and protection. As expected, we are starting to see some moderation in the level of sales from Mainland China into Hong Kong, which is expected to continue in the second half of the year. In Indonesia, sales have stabilised as we continue to take steps to broaden our product offering, improve our productivity and accelerate the pace of business automation. In Singapore and Malaysia, we are broadening our product offering and increasing the productivity of our distribution channels. Vietnam, India and Taiwan also made strong contributions to sales.

b) United States

Earned premiums, net of reinsurance in the US increased by 15 per cent from £6,818 million in half year 2016 to £7,829 million in half year 2017. Excluding the impact of exchange translation, earned premiums in the US increased by 1 per cent compared with £7,754 million on a constant exchange rate basis in half year 2016, including an increase in wholesale business.

Although industry volumes in the variable annuity market remain subdued following the declines in 2016, Jackson has continued to outperform the market[1] with an increase in variable annuity sales in the first half of 2017, reflecting the competitive strengths of Jackson s product offering and distribution capability. Total net inflows into Jackson s separate account asset balances, which drive fee-based earnings on variable annuity business, remain positive at £2.0 billion (half year 2016: £2.6 billion).

c) United Kingdom

Earned premiums, net of reinsurance for UK operations, increased from £4,861 million in half year 2016 to £5,875 million in half year 2017 primarily due to the sales of products that offer access to the PruFund s smoothed multi-asset fund returns.

Our UK business has emerged successfully from regulatory change in the retail savings and retirement market, driven by the strength of investment performance of its with-profits fund and the transparent structure of PruFund, with its distinctive smoothing process. By extending access to the PruFund investment option to a wider range of product wrappers, we have been able to achieve rapid growth in market segments such as flexible personal pensions and ISAs.

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Investment return

	2017 £m Half year	2016 £m Half year
Asia operations	**4,803**	2,683
US operations	**8,336**	2,528
UK operations	**7,440**	11,950
Unallocated corporate	**50**	(99)
Total	**20,629**	17,062

Investment return, principally comprises interest income, dividends, investment appreciation/ depreciation (realised and unrealised gains and losses) on investments designated as fair value through profit and loss and realised gains and losses, including impairment losses, on securities designated as available-for-sale. Movements in unrealised appreciation/depreciation of Jackson s debt securities designated as amortised cost and available-for-sale are not reflected in investment return but are recorded in other comprehensive income.

Allocation of investment return between policyholders and shareholders

Investment return is attributable to policyholders and shareholders. A key feature of the accounting policies under IFRS is that the investment return included in the income statement relates to all investment assets of the Group, irrespective of whether the return is attributable to shareholders, or to policyholders or the unallocated surplus of with-profits funds, the latter two of which have no direct impact on shareholders profit. The table below provides a breakdown of the investment return for each regional operation attributable to each type of business.

	2017 £m Half year	2016 £m Half year
Asia operations		
Policyholder returns		
Assets backing unit-linked liabilities	**1,534**	220
With-profits business	**2,509**	1,726
	4,043	1,946
Shareholder returns	**760**	737
Total	**4,803**	2,683
US operations		
Policyholders returns assets held to back (separate account) unit-linked liabilities	**8,818**	2,069
Shareholder returns	**(482)**	459
Total	**8,336**	2,528
UK operations		
Policyholder returns		
Scottish Amicable Insurance Fund (SAIF)	**247**	446
Assets held to back unit-linked liabilities	**1,269**	1,122
With-profits fund (excluding SAIF)	**5,019**	6,756
	6,535	8,324
Shareholder returns	**905**	3,626
Total	**7,440**	11,950

Unallocated corporate		
Shareholder returns	**50**	(99)
Group Total		
Policyholder returns	**19,396**	12,339
Shareholder returns	**1,233**	4,723
Total	**20,629**	17,062

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Policyholder returns

The returns as shown in the table above are delineated between those returns allocated to policyholders and those allocated to shareholders. In making this distinction, returns allocated to policyholders are those from investments in which shareholders have no direct economic interest, namely:

- Unit-linked business in the UK and Asia and Scottish Amicable Insurance Fund (SAIF) in the UK, for which the investment returns are wholly attributable to policyholders;
- Separate account business of US operations, the investment returns of which are also wholly attributable to policyholders; and
- With-profits business (excluding SAIF) in the UK and Asia (in which the shareholders economic interest, and the basis of recognising IFRS basis profits, is restricted to a share of the actuarially determined surplus for distribution (in the UK 10 per cent)). Except for this surplus the investment returns of the with-profits funds are attributable to policyholders (through the asset-share liabilities) or the unallocated surplus, which is accounted for as a liability under IFRS 4.

The investment returns related to the types of business mentioned above do not impact shareholders profits directly. However there is an indirect impact, for example, investment-related fees or the effect of investment returns on the shareholders share of the cost of bonuses of with-profits funds.

Investment returns for unit-linked and similar products have a reciprocal impact on benefits and claims, with an increase/decrease in market returns on the attached pool of assets affecting policyholder benefits on these products. Similarly for with-profits funds there is a close correlation between increases or decreases in investment returns and the level of combined charge for policyholder benefits and movement on unallocated surplus that arises from such returns.

Shareholder returns

For shareholder-backed non-participating business in the UK (comprising its shareholder-backed annuity and other non-linked non-participating business) and of the Asia operations, the investment returns are not directly attributable to policyholders and therefore, impact shareholders profit directly. However, for UK shareholder-backed annuity business where the durations of asset and liability cash flows are closely matched, the discount rate applied to measure liabilities to policyholders (under grandfathered UK GAAP and under IFRS 4) reflects movements in asset yields (after allowances for the future defaults) of the backing portfolios. Therefore, the net impact on the shareholders profits of the investment returns of the assets backing liabilities of the UK shareholder-backed annuity business is determined after taking into account the consequential effect on the movement in policyholder liabilities.

Changes in shareholders investment returns for US operations reflect primarily movements in the investment income, and realised gains and losses together with movements in the value of the derivative instruments held to manage interest rate exposures and durations within the general account (including variable annuity and fixed index annuity guarantees), GMIB reinsurance and equity derivatives held to manage the equity risk exposure of guarantee liabilities. Separately, within Benefits and Claims, there is a charge for the allocation made to policyholders through the application of crediting rates for Jackson s relevant lines of business.

The majority of the investments held to back the US general account business are debt securities for which the available-for-sale designation is applied for IFRS basis reporting. Under this designation the return included in the income statement reflects the aggregate of investment income and realised gains and losses (including impairment losses). However, movements in unrealised appreciation or depreciation are recognised in other comprehensive income. The return on these assets is attributable to shareholders.

Reasons for period-on-period changes in investment returns

With two exceptions, all Prudential investments are carried at fair value in the statement of financial position with fair value movements, which are volatile from period to period, recorded in the income statement. The exceptions are for:

(i) debt securities in the general account of US operations, the return on which is attributable to shareholders and which are accounted for on an IAS 39 available-for-sale basis. In this respect, realised gains and losses (including impairment losses) are recorded in the income statement, while movements in unrealised appreciation (depreciation) are booked as other comprehensive income. As a result, the changes in unrealised fair value of these debt securities are not reflected in Prudential s investment returns in the income statement. The unrealised gains and losses in the income statement of US operations primarily arise on the assets of the US separate account business; and

(ii) loans and receivables, which are generally carried at amortised cost (unless designated at fair value through profit and loss).

Subject to the effect of these two exceptions, the period-on-period changes in investment returns primarily reflect the generality of overall market movements for equities, debt securities and, in the UK, for investment property mainly held by with-profits funds. In addition, for Asia and US separate account business, foreign exchange rates affect the sterling value of the translated income. Consistent with the treatment applied for other items of income and expenditure, investment returns for overseas operations are translated at average exchange rates.

a) Asia

The table below provides an analysis of investment return attributable to Asia operations for the periods presented:

	2017 £m Half year	**2016 £m Half year**
Interest/dividend income (including foreign exchange gains and losses)	**783**	719
Investment appreciation*	**4,020**	1,964
Total	**4,803**	2,683

* Investment appreciation comprises net realised and unrealised gains and losses on the investments.

In Prudential s Asia operations, equities and debt securities accounted for 38 per cent and 55 per cent, respectively of the total investment portfolio at 30 June 2017. The remaining 7 per cent of the total investment portfolio was primarily loans and deposits with credit institutions. At 30 June 2016, the total proportion of the investment portfolio invested in equities and debt securities was 37 per cent and 58 per cent respectively, with the remaining 5 per cent similarly invested in loans and deposits with credit institutions. In Asia, investment returns increased from £2,683 million in half year 2016 to £4,803 million in half year 2017. This increase in investment returns primarily reflects investment appreciation of £2,056 million from £1,964 million in half year 2016 to £4,020 million in half year 2017 due to favourable movements in equity markets across the region and gains on bonds in certain business units from falling interest rates.

b) United States

The table below provides an analysis of investment return attributable to US operations for the periods presented:

	2017 £m Half year	**2016 £m Half year**
Investment return of investments backing US separate account liabilities	**8,818**	2,069

Other investment returns	**(482)**	459
Total	**8,336**	2,528

In the US, investment returns increased from £2,528 million in half year 2016 to £8,336 million in half year 2017. This £5,808 million favourable change arose from an increase of £6,749 million in the investment returns on investments backing variable annuity separate account liabilities from a gain of £2,069 million in half year 2016 to a gain of £8,818 million in half year 2017 and this increase was partially offset by a decrease in other investment returns from a gain of £459 million to a loss of £482 million. The primary driver for the increase in investment returns on investments backing variable annuity separate account liabilities, as compared to the same period in 2016, was the more favourable movement in the US equity markets in half year 2017 than that experienced in half year 2016. The decrease of £941 million in other investment returns reflects the value movements in derivatives held to manage interest rate and equity risk exposures as noted previously and as discussed in note B1.2 to the unaudited condensed consolidated interim financial statements.

c) United Kingdom

The table below provides an analysis of investment returns attributable to UK operations for the periods presented:

	2017 £m Half year	2016 £m Half year
Interest/dividend income	**3,442**	3,363
Investment appreciation (depreciation) and other investment returns	**3,998**	8,587
Total	**7,440**	11,950

In Prudential s UK operations, equities, debt securities and investment properties accounted for 29 per cent, 47 per cent and 8 per cent, respectively of the total investment portfolio at 30 June 2017. The remaining 16 per cent of the total investment portfolio at 30 June 2017 comprised loans, deposits with credit institutions, investment in partnerships in investment pools and derivative assets. At 30 June 2017, the total proportion of the investment portfolio held in equities, debt securities and investment properties was of a similar magnitude to that as at 30 June 2016. The decrease in investment appreciation and other investment returns from a gain of £8,587 million in half year 2016 to a gain of £3,998 million in half year 2017 primarily reflects the more significant gains on bonds in the prior period due to the fall in UK gilt yields in the first half of 2016. The investment appreciation in half year 2017 primarily reflects valuation movement due to the favourable equity markets during the period.

d) Unallocated corporate and intragroup elimination

The investment returns for unallocated corporate and intragroup elimination increased by £149 million from a loss of £99 million in half year 2016 to a gain of £50 million in half year 2017. The returns in the period include the unrealised value movements on financial instruments and foreign exchange items.

Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance

	2017 £m Half year	2016 £m Half year
Asia operations*	**(9,281)**	(6,064)
US operations	**(15,056)**	(9,704)
UK operations*	**(11,105)**	(15,171)
Total	**(35,442)**	(30,939)

* After elimination of intra-group transactions between these two segments.

Benefits and claims represent payments, including final bonuses, to policyholders in respect of maturities, surrenders and deaths plus the change in technical provisions (which primarily represents the movement in amounts owed to policyholders). Benefits and claims are amounts attributable to policyholders. The movement in unallocated surplus of with-profits funds represents the transfer to (from) the unallocated surplus each year through a charge (credit) to the income statement of the annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders.

The underlying reasons for the period to period changes in benefits and claims and movement in unallocated surplus in each of Prudential s regional operations are changes in the incidence of claims incurred, increases or decreases in policyholders liabilities, and movements in unallocated surplus of with-profits funds.

The charge for total benefits and claims and movement in unallocated surplus, net of reinsurance, of with-profits funds increased to £35,442 million in half year 2017 from £30,939 million in half year 2016. The amounts of the period to period change attributable to each of the underlying reasons as stated above are shown below:

	2017 £m Half year	**2016 £m Half year**
Claims incurred, net of reinsurance	**(15,069)**	(12,196)
Increase in policyholder liabilities, net of reinsurance	**(19,443)**	(18,450)
Movement in unallocated surplus of with-profits funds	**(930)**	(293)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(35,442)**	(30,939)

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The charge for benefits and claims and movements in unallocated surplus, net of reinsurance of £35,442 million for half year 2017 (half year 2016: £30,939 million) shown in the table above includes the effect of accounting for investment contracts without discretionary participation features (as defined by IFRS 4) in accordance with IAS 39 to reflect the deposit nature of the arrangement.

Additionally, the movement in policyholder liabilities and unallocated surplus of with-profits funds represents the amount recognised in the income statement and therefore excludes the effect of foreign exchange translation differences on the policyholder liabilities of foreign subsidiaries and the movement in liabilities arising on acquisitions and disposals of subsidiaries in the period.

The movement in policyholder liabilities recognised in the income statement includes reserving for inflows from premiums net of upfront charges, release of liabilities for claims paid on surrenders, withdrawals, maturities and deaths, change due to investment return to the extent of the amounts allocated to policyholders or reflected in the measurement of the policyholder liabilities and other changes in the liability measurement.

However, the principal driver for the period on period variations in the increases and decreases in policyholder liabilities is the investment return element due to the inherent nature of market fluctuations.

These variations are driven by changes to investment returns reflected in the balance sheet measurement of liabilities for Prudential s with-profits, SAIF and unit-linked policies (including the US separate account business). In addition, for those liabilities under IFRS, in particular liabilities relating to the UK annuity business, where the measurement reflects the yields on assets backing the liabilities, the period to period changes in investment yields also contribute significantly to variations in the measurement of policyholder liabilities. The principal driver for variations in the change in unallocated surplus of with-profits funds is the value movements on the investment assets of the with-profits funds to the extent not reflected in the policyholder liabilities.

An analysis of statement of financial position movements in policyholder liabilities and unallocated surplus of with-profits funds is provided in note C4.1 to the unaudited condensed consolidated financial statements. The policyholder liabilities shown in the analysis in note C4.1 are gross of reinsurance and include the full movement in the period of investment contracts without discretionary participating features (as defined in IFRS 4). Further, this analysis has been prepared to include the Group s share of the policyholder liabilities of the Asia joint ventures that are accounted for on an equity method basis in the Group s financial statements.

The principal variations in the increases or decreases in policyholder liabilities and movements in unallocated surplus of with-profits funds for each regional operation are discussed further below.

a) Asia

In half year 2017, the charge for benefits and claims and movement in unallocated surplus of with-profits funds totalled £9,281 million, representing an increase of £3,217 million compared to £6,064 million in half year 2016. The amounts of the period to period change attributable to each of the underlying reasons are shown below:

	2017 £m Half year	**2016 £m Half year**
Claims incurred, net of reinsurance	**(2,495)**	(1,988)

Increase in policyholder liabilities, net of reinsurance	**(6,291)**	(4,502)
Movement in unallocated surplus of with-profits funds	**(495)**	426
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(9,281)**	(6,064)

The growth in policyholder liabilities reflected the increase due to the combined growth of new business and the in-force books in the region.

The variations in the increases or decreases in policyholder liabilities in individual periods were however, primarily due to movements in investment returns. This was as a result of asset value movements, which are reflected in the unit value of the unit-linked policies that represent a significant proportion of Asian business. In addition, the policyholder liabilities of the Asian operations with-profits policies also fluctuated with the investment performance of the funds.

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b) United States

Except for institutional products and certain term annuities which are classified as investment products under IAS 39, the products are accounted for as insurance contracts for IFRS reporting purposes. On this basis of reporting, deposits into these products are recorded as premiums while, withdrawals and surrenders are included in benefits and claims, and the resulting net movement is recorded under other reserve movements within benefits and claims. Benefits and claims also include interest credited to policyholders in respect of deposit products less fees charged on these policies.

In half year 2017, the accounting charge for benefits and claims increased by £5,352 million to £15,056 million compared to £9,704 million in the same period in the prior year. The amounts of the period to period change attributable to each of the underlying reasons are described below:

	2017 £m Half year	**2016 £m Half year**
Claims incurred, net of reinsurance	**(6,962)**	(5,007)
Increase in policyholder liabilities, net of reinsurance	**(8,094)**	(4,697)
Benefits and claims, net of reinsurance	**(15,056)**	(9,704)

The period-on-period movement in claims incurred for US operations as shown in the table above also includes the effect of translating the US results into pounds sterling at the average exchange rates for the relevant periods.

The charges in each period comprise amounts in respect of variable annuity and other business. There are two principal factors that contribute to the variations in the charge in any given period First, the level of net flows into the business (comprising premiums less maturities and surrenders), which for half year 2017 were £1,958 million compared to £2,855 million for half year 2016. The second principal effect is the investment returns on the assets backing the policyholder liabilities, which has increased during the period primarily due to favourable equity markets in the US. In particular, the investment returns on the assets backing the variable annuity separate account liabilities increased from £2,069 million in half year 2016 to £8,818 million in half year 2017.

c) United Kingdom

The overall charge for benefits, claims and the transfer to unallocated surplus decreased from £15,171 million charge in half year 2016 to £11,105 million in half year 2017. The amounts of the period to period change attributable to each of the underlying reasons are shown below, together with a further analysis of the change in policyholder liabilities by type of business:

	2017 £m Half year	**2016 £m Half year**
Claims incurred, net of reinsurance	**(5,615)**	(5,201)
(Increase) decrease in policyholder liabilities, net of reinsurance:		
SAIF	**179**	13
Shareholder-backed annuity business	**523**	(2,692)
Unit-linked and other non-participating business	**(826)**	(488)
With-profits (excluding SAIF)	**(4,934)**	(6,084)
	(5,058)	(9,251)

Movement in unallocated surplus of with-profits funds	**(432)**	(719)
Benefits and claims and movement in unallocated surplus, net of reinsurance	**(11,105)**	(15,171)

Claims incurred in the UK operations of £5,615 million in half year 2017 represented an increase from £5,201 million incurred in half year 2016.

As has been explained above, the principal driver for variations in amounts allocated to the policyholders is changes to investment returns.

In aggregate, as a result of the lower market returns in half year 2017 compared to half year 2016 there has been a corresponding impact on benefits and claims and movements in unallocated surplus of with-profits funds in this half year, moving from a net charge of £15,171 million in half year 2016 to a net charge of £11,105 million in half year 2017.

SAIF is a ring-fenced fund with no new business written. The decrease in policyholder liabilities in SAIF reflects the run off of the underlying liabilities. The variations from period to period are, however, affected by the market valuation movement of the investments held by SAIF, which are wholly attributable to policyholders.

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For shareholder-backed annuity business, the decreases/(increases) in policyholder liabilities reflect the effect of altered investment yield reflected in the discount rate applied in the measurement of the liabilities and other altered assumptions where relevant, together with net flows into this line of business. Following the withdrawal from selling non-profit retail annuities which have higher capital requirements than other lines of business, net flows were negative in the period thereby reducing policyholder liabilities.

For unit-linked business, the variations in the increases in the related policyholder liabilities were primarily due to the movement in the market value of the unit-linked assets as reflected in the unit value of the unit-linked policies.

The part of Prudential where variations in amounts attributed to policyholder liabilities and unallocated surplus are most significant is the UK with-profits business (excluding SAIF). The liabilities for UK with-profits policyholders are determined on an asset-share basis that incorporates the accumulation of investment returns and all other items of income and outgoings that are relevant to each policy type. Accordingly, movement in the policyholder liabilities in the income statement will fluctuate with the investment returns of the fund. Separately, the excess of assets over liabilities of the fund represents the unallocated surplus. This surplus will also fluctuate on a similar basis to the market value movement on the investment assets of the funds with the movement reflected in the income statement. In addition, other items of income and expenditure affect the level of movement in policyholder liabilities (to the extent reflected in asset shares) and unallocated surplus.

The correlation between total net income (loss) before benefits and claims and movement in unallocated surplus, on the one hand, and the (charge) credit for benefits and claims and movement in unallocated surplus, on the other, for the UK component of the PAC with-profits fund (excluding SAIF) principally arises due to the following factors:

(a) Investment returns included in full in the income statement and are attributable either to contracts or unallocated surplus.

(b) Investment returns, to the extent attributable to contracts, directly affect asset-share liabilities, which are reflected in the income statement through changes in policyholder liabilities.

(c) Investment returns, to the extent attributable to unallocated surplus, form the majority part of the movement in such surplus in the income statement.

Separately, the cost of current year bonuses which is attributable to policyholders is booked within the movement in policyholder liabilities. One-ninth of the declared cost of policyholders bonus is attributable to shareholders and represents the shareholders profit. Both of these amounts, by comparison with the investment returns, movement in other constituent elements of the change in policyholder liabilities and the change in unallocated surplus, are relatively stable from period to period.

The surplus for distribution in future years will reflect the aggregate of policyholder bonuses and the cost of bonuses attributable to shareholders, which is currently set at 10 per cent. In general, the policyholder bonuses comprise the aggregate of regular and final bonuses. When determining policy payouts, including final bonuses, Prudential considers asset shares of specimen policies. Where policies are invested in one of the PruFund Range of Funds, the approach differs; such policies participate in profits by means of an increase in the unit price of the selected investment fund.

Prudential does not take into account the surplus assets of the long-term fund, or the investment returns, in calculating asset shares. Asset-shares are used in the determination of final bonuses, together with requirements concerning treating customers fairly, the need to smooth claim values and payments from year to year and competitive considerations.

In the unlikely circumstance that the depletion of excess assets within the long-term fund was such that Prudential s ability to treat its customers fairly was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders funds to the long-term funds to provide financial support.

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Acquisition costs and other expenditure

	2017 £m Half year	2016 £m Half year
Asia operations	**(2,200)**	(1,769)
US operations	**(1,234)**	(598)
UK operations	**(1,947)**	(1,223)
Unallocated corporate and intragroup elimination	**51**	27
Total	**(5,330)**	(3,563)

Total acquisition costs and other expenditure of £5,330 million in half year 2017 were 50 per cent higher than the £3,563 million incurred in half year 2016. In general, acquisition costs and other expenditure comprise acquisition costs incurred for insurance policies, change in deferred acquisition costs, operating expenses and movements in amounts attributable to external unit holders. Movements in amounts attributable to external unit holders are in respect of the funds managed on behalf of third parties which are consolidated but have no recourse to the Group and reflect the change in the overall returns in these funds in the period.

a) Asia

Total acquisition costs and other expenditure for Asia in half year 2017 were £2,200 million representing an increase of £431 million compared with £1,769 million in half year 2016. The increase of £431 million includes an exchange translation impact of £230 million. Excluding the currency volatility, the total acquisitions and other expenditure increased by £201 million from half year 2016 to half year 2017.

The period on period increase primarily reflects increased acquisition costs, net of change in deferred acquisition costs following a rise in sales in the period together with increases in other operating expenses as the business continues to expand.

b) United States

Total acquisition costs and other expenditure for the US of £1,234 million in half year 2017 represented an increase of £636 million against the £598 million incurred in half year 2016. The increase of £636 million includes an exchange translation impact of £82 million. Excluding the currency volatility, total acquisition costs and other expenditure increased by £554 million from half year 2016 to half year 2017.

The period on period increase primarily reflects changes in the amortisation of deferred acquisition costs in the income statement which, excluding the impact of currency volatility, increased by £436 million from a credit of £431 million (on a constant exchange rate basis) in half year 2016 to a charge of £5 million in half year 2017. A significant element is due to the amortisation attaching to the varying level of short-term fluctuations in investment returns in each period.

c) United Kingdom

Total acquisition costs and other expenditure for the UK increased by 59 per cent from £1,223 million in half year 2016 to £1,947 million in half year 2017. This increase arose primarily from the increase in the charge for investment gains attributable to external unit-holders relating to funds managed on behalf of third parties which are consolidated but have no recourse to the Group, such charges increased by £549 million from £121 million in half year 2016 to £670 million in half year 2017.

d) Unallocated corporate and intragroup elimination

Other net expenditure comprising a credit of £51 million in half year 2017 increased compared to the credit of £27 million in half year 2016. Other net expenditure comprises both the other expenditure of the unallocated corporate and elimination of intragroup income and expenses such as the asset management fees charged by the Group s asset management businesses to the insurance operations.

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Exchange Rate Information

Prudential publishes its consolidated financial statements in pounds sterling. References in this document to US dollars , US$, $ or ¢ are to US currency, references to pounds sterling , £ , pounds , pence or p are to UK are 100 pence to each pound) and references to Euro or are to the single currency adopted by the participating members of the European Union. The following table sets forth for each period the average of the noon buying rates on the last business day of each month of that period, as certified for customs purposes by the Federal Reserve Bank of New York, for pounds sterling expressed in US dollars per pound sterling for each of the reported periods. Prudential has not used these rates to prepare its consolidated financial statements.

Period	Average rate
Six months ended 30 June 2016	1.43
Twelve months ended 31 December 2016	1.35
Six months ended 30 June 2017	1.26

The following table sets forth the high and low noon buying rates for pounds sterling expressed in US dollars per pound sterling for each of the previous six months:

	High	Low
February 2017	1.26	1.24
March 2017	1.26	1.22
April 2017	1.29	1.24
May 2017	1.30	1.28
June 2017	1.30	1.26
July 2017	1.31	1.29

On 4 August 2017, the latest practicable date prior to this filing, the noon buying rate was £1.00 = $1.30.

EEV Basis, New Business Results and Free Surplus Generation

In addition to IFRS basis results, Prudential s filings with the UK Listing Authority, the Stock Exchange of Hong Kong, the Singapore Stock Exchange and Group Annual Reports include reporting by Key Performance Indicators (KPIs). These include results prepared in accordance with the European Embedded Value (EEV) Principles and Guidance issued by the European Insurance CFO Forum, New Business and Free Surplus Generation measures.

The EEV basis is a value-based method of reporting in that it reflects the change in the value of in-force long-term business over the accounting period. This value is called the shareholders funds on the EEV basis which, at a given point in time, is the value of future cash flows expected to arise from the current book of long-term insurance business plus the net worth (based on statutory solvency capital or economic capital where higher and free surplus) of Prudential s life insurance operations. Prudential publishes its EEV results semi-annually in the UK, Hong Kong and Singapore markets.

New business results are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. New business results are categorised as single premiums and annual regular premiums. New business results are also summarised by annual premium equivalents (APE) which are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. The amounts are not, and are not intended to be, reflective of premium income recorded in the IFRS income statement. EEV basis new business profits and margins are also published semi-annually.

Underlying free surplus generation is used to measure the internal cash generation by our business units. For the insurance operations it represents amounts maturing from the in-force business during the period less investment in new business and excludes other non-operating items. For asset management it equates to post-tax IFRS operating profit based on longer-term investment return for the period.

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Additional Information on Liquidity and Capital Resources

Prudential Capital operates a central treasury function for Prudential, which has overall responsibility for managing Prudential s capital funding program as well as its central cash and liquidity positions. Prudential arranges the financing of each of its subsidiaries primarily by raising external finance either at the parent company level or at the operating company level.

After making sufficient enquiries the directors of Prudential have a reasonable expectation that the Company and the Group have adequate resources to continue their operations for a period of at least 12 months from the date that the financial statements are approved.

Liquidity sources

The parent company including the central finance subsidiaries held cash and short-term investments of £2,657 million as at 30 June 2017 and £2,626 million as at 31 December 2016. The sources of cash in half year 2017 included dividends, loans and net cash amounts received from operating subsidiaries. Prudential received £1,230 million in net cash remittances from business units in half year 2017, compared with £1,118 million received in half year 2016. These remittances primarily comprise dividends from business units and the shareholders statutory transfer from the PAC long-term with-profits fund (UK Life Fund) relating to earlier bonus declarations.

Dividends, loans and net cash amounts received from subsidiaries

Under UK company law, dividends can only be paid if a company has distributable reserves sufficient to cover the dividend. In PAC, Prudential s largest operating subsidiary, distributable reserves arise from the emergence of profits from the company s long-term business. For the company s with-profits business the profits reflect the profit transfer to shareholders that occurs upon the declaration of bonuses to policyholders of with-profit products. Prudential s insurance and fund management subsidiaries ability to pay dividends and loans to the parent company is restricted by various laws and regulations. Jackson is subject to state laws that limit the dividends payable to its parent company. Dividends in excess of these limitations generally require approval of the state insurance commissioner. The table below shows the dividends, loans and other net cash amounts received by Prudential from the principal operating subsidiaries for the first half of 2017 and 2016.

	2017 £m Half year	**2016 £m Half year**
Asia Operations	**350**	258
US Operations	**475**	339
UK Life	**215**	215
M&G	**175**	150
Prudential Capital	**15**	25
Other UK	**-**	131
Total	**1,230**	1,118

Each of Prudential s main operations generates sufficient profits to pay dividends to the parent. The amount of dividends paid by the operations is determined after considering the development, growth and investment requirements of the operating businesses. Prudential does not believe that the legal and regulatory restrictions on the ability of any one of its businesses to pay dividends to the parent, constitutes a material limitation on the ability of Prudential plc to meet its cash obligations.

Consolidated Cash Flows

The discussion that follows is based on the consolidated statement of cash flows prepared under IFRS and presented in Prudential s unaudited condensed consolidated interim financial statements.

Net cash outflows in the first half of 2017 were £140 million. This amount comprised inflows of £90 million from operating activities and £757 million from investing activities, less outflows of £987 million from financing activities. During the first half of 2016 net cash inflows were £57 million comprising inflows of £803 million from operating activities, less outflows of £334 million from investing activities and £412 million from financing activities.

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As at 30 June 2017, the Group held cash and cash equivalents of £9,893 million compared with £10,065 million at 31 December 2016, an decrease of £172 million (representing net cash outflows of £140 million outlined above, and the effect of exchange rate changes of £32 million).

Contingencies and Related Obligations

Details of the main changes to Prudential s contingencies and related obligations that have arisen in the six month period ended 30 June 2017 are set out in note D2 to the unaudited condensed consolidated interim financial statements.

Derivative Financial Instruments

Details of the uses of derivative financial instruments by Prudential are as provided in the Group s 2016 annual report on Form 20-F.

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Risk Management

1. Introduction

We continue to operate in a global environment of political uncertainty, although financial markets have remained resilient through the first half of the year. As we position ourselves, we remain mindful of the uncertain environment from a political, economic and social perspective.

As in previous years, we continue to maintain a strong and sustained focus on planning for the possibility of, and ultimately managing, the market volatility and macroeconomic uncertainty arising from the global environment. Our Risk Management Framework and risk appetite have allowed us to successfully control our risk exposure throughout the year. Our governance, processes and controls enable us to deal with the uncertainty ahead in order to continue helping our customers achieve their long-term financial goals.

Our results show that, even in times of such unpredictability, we can generate value for our shareholders by selectively taking exposure to risks that are adequately rewarded and that can be appropriately quantified and managed. We retain risks within a clearly defined risk appetite, where we believe doing so contributes to value creation and the Group is able to withstand the impact of an adverse outcome. For our retained risks, we ensure that we have the necessary capabilities, expertise, processes and controls to appropriately manage the exposure.

This section explains the main risks inherent in our business and how we manage those risks, with the aim of ensuring we maintain an appropriate risk profile.

2. Risk governance, culture and our risk management cycle

Prudential defines risk as the uncertainty that we face in successfully implementing our strategies and objectives. This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Group. Accordingly, material risks will be retained selectively where we think there is value to do so, and where it is consistent with the Group s risk appetite and philosophy towards risk-taking.

The following section provides more detail on our risk governance, culture and risk management process.

a. Risk governance

Our risk governance comprises the organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that the Group Head Office and our business units establish to make decisions and control their activities on risk-related matters. This encompasses individuals, Group-wide functions and committees involved in managing risk.

i. Risk committees and governance structure

Our Risk governance structure is led by the Group s Risk Committee, supported by independent non-executives on risk committees of major subsidiaries. These committees monitor the development of the risk management framework, the Group s risk appetites, limits, and policies, as well as its risk culture. We have a comprehensive risk management cycle in place to identify, measure, manage and monitor our risk exposures.

In addition to our risk committees, there are various executive risk forums to ensure risk issues are shared and considered across the Group. These are led by the Group Executive Risk Committee which is supported by a number of specific sub-committees including security and information security where specialist skills and knowledge are required.

ii. Risk Management Framework

The Group s Risk Management Framework has been developed to monitor and manage the risk of the business at all levels and is owned by the Board. The aggregate Group exposure to the key risk drivers is monitored and managed by the Group Risk function which is responsible for reviewing, assessing and reporting on the Group s risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

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The Framework requires all our businesses and functions to establish processes for identifying, evaluating and managing the key risks faced by the Group the Risk Management Cycle (see below) is based on the concept of the three lines of defence , comprising risk taking and management, risk control and oversight, and independent assurance.

A major part of the Risk Management Cycle is the annual assessment of the Group s risks which are considered key. These key risks range from risks associated with the economic, market, political and regulatory environment; those that we assume when writing our insurance products and by virtue of the investments we hold; and those that are inherent in our business model and its operation. This is used to inform risk reporting to the risk committees and the Board for the year.

iii. Risk appetite, limits and triggers

The extent to which we are willing to take risk in the pursuit of our objective to create shareholder value is defined by a number of risk appetite statements, operationalised through measures such as limits, triggers and indicators. The Group risk appetite is approved by the Board and is set with reference to economic and regulatory capital, liquidity and earnings volatility. The Group risk appetite is aimed at ensuring that we take an appropriate level of aggregate risk and covers all risks to shareholders, including those from participating and third party business.

We have no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement and monitor appropriate controls to manage operational risks. Group limits operate within the risk appetite to constrain the material risks, while triggers and indicators provide further constraint and ensure escalation. The Group Chief Risk Officer determines the action to be taken upon all breaches of Group limits.

The Group Risk function is responsible for reviewing the scope and operation of these measures at least annually, to determine that they remain relevant. The Board approves all changes made to the Group s Risk Appetite Framework. We define and monitor aggregate risk limits based on financial and non-financial stresses for our earnings volatility, liquidity and capital requirements.

Earnings volatility:

The objectives of the aggregate risk limits seek to ensure that:

- The volatility of earnings is consistent with the expectations of stakeholders;
- The Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks; and
- Earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies.

The two measures used to monitor the volatility of earnings are IFRS operating profit and EEV operating profit, although IFRS and EEV total profits are also considered.

Liquidity:

The objective is to ensure that the Group is able to generate sufficient cash resources to meet financial obligations as they fall due in business as usual and stressed scenarios. Risk appetite with respect to liquidity risk is measured using a Liquidity Coverage Ratio which considers the sources of liquidity versus liquidity requirements under stress scenarios.

Capital requirements:

The limits aim to ensure that:

- The Group meets its internal economic capital requirements;
- The Group achieves its desired target rating to meet its business objectives; and
- Supervisory intervention is avoided.

The two measures used at the Group level are Solvency II capital requirements and internal economic capital requirements. In addition, capital requirements are monitored on local statutory bases.

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The Group Risk Committee is responsible for reviewing the risks inherent in the Group s business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is supported by the Group Risk function, which uses submissions from our local business units to calculate the Group s aggregated position (allowing for diversification effects between local business units) relative to the aggregate risk limits.

iv. Risk policies

These set out the specific requirements which cover the fundamental principles for risk management within the Group Risk Framework. Policies are designed to give some flexibility so that business users can determine how best to comply with policies based on their local expertise.

There are core risk policies for credit, market, insurance, liquidity and operational risks and a number of internal control policies covering internal model risk, underwriting, dealing controls and tax risk management. They form part of the Group Governance Manual, which was developed to make a key contribution to the sound system of internal control that we maintain in line with the UK Corporate Governance Code and the Hong Kong Code on Corporate Governance Practices. Group Head Office and business units must confirm that they have implemented the necessary controls to evidence compliance with the Group Governance Manual on an annual basis.

v. Risk standards

The Group-wide Operating Standards provide supporting detail to the higher level risk policies. In many cases they define the minimum requirements for compliance with Solvency II regulations which in some areas are highly prescriptive. The standards are more detailed than policies.

b. Our risk culture

Culture is a strategic priority of the Board who recognise the importance of good culture in the way that we do business. Risk culture is a subset of broader organisational culture, which shapes the organisation-wide values that we use to prioritise risk management behaviours and practices.

An evaluation of risk culture is part of the Risk Management Framework and in particular seeks to identify evidence that:

- Senior management in business units articulate the need for good risk management as a way to realise long-term value and continuously support this through their actions;
- Employees understand and care about their role in managing risk they are aware of and openly discuss risk as part of the way they perform their role; and
- Employees invite open discussion on the approach to the management of risk.

Key aspects of risk culture are also communicated through the Code of Conduct and the policies in the Group Governance Manual, including the commitments to the fair treatment of our customers and staff. The approach to the management of risk also is a key part of the evaluation of the remuneration of executives. Risk culture is an evolving topic across the financial services industry and we are working to evaluate and embed a strong risk culture.

c. The risk management cycle

The risk management cycle comprises processes to identify, measure and assess, manage and control, and monitor and report on our risks.

i. Risk identification

Group-wide risk identification takes place throughout the year and includes processes such as our Own Risk and Solvency Assessment (ORSA) and the horizon-scanning performed as part of our emerging risk management process.

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On an annual basis, a top-down identification of the Group s key risks is performed which considers those risks that have the greatest potential to impact the Group s operating results and financial condition. A bottom-up process of risk identification is performed by the business units who identify, assess and document risks, with appropriate coordination and challenge from the risk functions.

The Group ORSA report pulls together the analysis performed by a number of risk and capital management processes, which are embedded across the Group, and provides quantitative and qualitative assessments of the Group s risk profile, risk management and solvency needs on a forward-looking basis. The scope of the report covers the full known risk universe of the Group.

The Directors perform a robust assessment of the principal risks facing the Company, through the Group ORSA report and the risk assessments done as part of the business planning review, including how they are managed and mitigated.

Reverse stress testing, which requires us to ascertain the point of business model failure, is another tool that helps us to identify the key risks and scenarios that may materially impact the Group.

Our emerging risk management process identifies potentially material risks which have a high degree of uncertainty around timing, magnitude and propensity to evolve. The Group holds emerging risk sessions over the year to identify emerging risks which includes input from local subject matter and industry experts. We maintain contacts with thought leaders and peers to benchmark and refine our process.

The risk profile is a key output from the risk identification and risk measurement processes, and is used as a basis for setting Group-wide limits, management information, assessment of solvency needs, and determining appropriate stress and scenario testing. The risk identification processes support the creation of our annual set of key risks, which are then given enhanced management and reporting focus.

ii. Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. All quantifiable risks which are material and mitigated by holding capital are modelled in the Group s internal model, which is used to determine capital requirements under Solvency II and our own economic capital basis. Governance arrangements are in place to support the internal model, including independent validation and process and controls around model changes and limitations.

iii. Risk management and control

The control procedures and systems established within the Group are designed to reasonably manage the risk of failing to meet business objectives and are detailed in the Group risk policies. This can only provide reasonable and not absolute assurance against material misstatement or loss. They focus on aligning the levels of risk-taking with the achievement of business objectives.

The management and control of risks are set out in the Group risk policies, and form part of the holistic risk management approach under the Group s ORSA. These risk policies define:

The Group s risk appetite in respect of material risks, and the framework under which the Group s exposure to those risks is limited;

The processes to enable Group senior management to effect the measurement and management of the Group material risk profile in a consistent and coherent way; and

The flows of management information required to support the measurement and management of the Group material risk profile and to meet the needs of external stakeholders.

The methods and risk management tools we employ to mitigate each of our major categories of risks are detailed in section 4 below.

iv. Risk monitoring and reporting

The identification of the Group s key risks informs the management information received by the Group risk committees and the Board. Risk reporting of key exposures against appetite is also included, as well as ongoing developments in other key and emerging risks.

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3. Summary risks

The table below is a summary of the key risks facing the Group, which can be grouped into those which apply to us because of the global environment in which we operate, and those which arise as a result of the business that we operate including risks arising from our investments, the nature of our products and from our business operations.

Macro - risks

Some of the risks that we are exposed to are necessarily broad given the external influences which may impact on the Group. These risks include:

Global economic conditions. Changes in global economic conditions can impact us directly; for example by leading to poor returns on our investments and increasing the cost of promises we have made to our customers. They can also have an indirect impact; for example economic pressures could lead to decreased savings, reducing the propensity for people to buy our products. Global economic conditions may also impact on regulatory risk for the Group by changing prevailing political attitudes towards regulation.

Geopolitical risk. The geopolitical environment is increasingly uncertain with political upheaval in the UK, the US and the Eurozone. Uncertainty in these regions, combined with conflict in the Middle East and increasing tensions in east Asia underline that geopolitical risks are truly global and their potential impacts are wide-ranging; for example through increased regulatory risk. The geopolitical and economic environments are increasingly closely linked, and changes in the political arena may have direct or indirect impacts on our Group.

Digital disruption. The emergence of advanced technologies such as artificial intelligence and blockchain is providing an impetus for companies to rethink their existing operating models and how they interact with their customers. Prudential is embracing the opportunities presented by digitalisation and is closely monitoring any risks which arise.

Risks from our investments	Risks from our products	Risks from our business operations
Global economic conditions see above have a large impact on those risks from our investments.	**Insurance risks**	**Operational risks**
Our fund investment performance is a fundamental part of our business in providing appropriate returns for our customers and shareholders, and so is an important area of focus.	The nature of the products offered by the Group exposes it to insurance risks, which are a significant part of our overall risk profile.	As a Group, we are dependent on the appropriate and secure processing of a large number of transactions by our people, IT infrastructure and outsourcing partners, which exposes us to operational risks and reputational risks.
Credit risk	The insurance risks that we are exposed to by virtue of our products include **longevity risk** (policyholders living longer than expected); **mortality risk** (policyholders with life protection dying); **morbidity risk** (policyholders with health	**Information security risk** is a significant consideration within operational risk, including both the risk of malicious attack on our systems as well as risks relating to data security and integrity and
Is the potential for reduced value of our investments due to the uncertainty		

around investment returns arising from the potential for defaults of our investment counterparties.

Invested credit risk arises from our asset portfolio. We increase sector focus where necessary.

The assets backing the UK and Jackson s annuity business mean credit risk is a significant focus for the Group.

Market risk

Is the potential for reduced value of our investments resulting from the volatility of asset prices as driven by fluctuations in equity prices, interest

protection becoming ill) and **persistency risk** (customers lapsing their policies).

From our health protection products, increases in the costs of claims (including the level of medical expenses) increasing over and above price inflation (claim inflation) is another risk.

The processes that determine the price of our products and reporting the results of our long-term

network disruption. The size of Prudential s IT infrastructure and network, our move toward digitisation and the increasing number of high profile cyber security incidents across industries means that this will continue to be an area of high focus.

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Risks from our investments

rates, foreign exchange rates and property prices.

In our Asia business, our main market risks arise from the value of fees from our fee-earning products.

In the US, Jackson s fixed and variable annuity books are exposed to a variety of market risks due to the assets backing these policies.

In the UK, exposure relates to the valuation of the proportion of the with-profits fund s future profits which is transferred to the shareholders (future transfers), which is dependent on equity, property and bond values.

M&G invests in a broad range of asset classes and its income is subject to the price volatility of global financial and currency markets.

Liquidity risk

Is the risk of not having sufficient liquid assets to meet our obligations as they fall due, and incorporates the risk arising from funds composed of illiquid assets. It results from a mismatch between the liquidity profile of assets and liabilities.

Risks from our products

business operations require us to make a number of assumptions. Where experience deviates from these assumptions our profitability may be impacted.

Across our business units, persistency and morbidity risks are among the largest insurance risks for our Asia business given our strong focus on health protection products in the region.

For the UK and Jackson, the most significant insurance risk is longevity risk driven by their annuity businesses.

Risks from our business operations

Regulatory risk

We also operate under the ever-evolving requirements set out by diverse regulatory and legal regimes (including tax), as well as utilising a significant number of third parties to distribute products and to support business operations; all of which add to the complexity of the operating model if not properly managed.

The number of regulatory changes under way across Asia, in particular those focusing on consumer protection means that regulatory change in the region also is considered a key risk.

Both Jackson and the UK operate in highly regulated markets. Regulatory reforms could materially impact our businesses, and regulatory focus continues to be high.

4. <u>Further risk information</u>

In reading the sections below, it is useful to understand that there are some risks that our policyholders assume by virtue of the nature of their products, and some risks that the Company and its shareholders assume. Examples of the latter include those risks arising from assets held directly by and for the Company or the risk that policyholder funds are exhausted. This report is focused mainly on risks to the shareholder, but will include those which arise indirectly through our policyholder exposures.

4.1 Risks from our investments

a. Market risk

The main drivers of market risk in the Group are:

- Investment risk (including equity and property risk);
- Interest rate risk; and
- Given the geographical diversity of our business, foreign exchange risk.

With respect to investment risk, equity and property risk arises from our holdings of equity and property investments, the prices of which can change depending on market conditions.

The valuation of our assets (particularly the bonds that we invest in) and liabilities are also dependent on market interest rates and exposes us to the risk of those moving in a way that is detrimental for us.

Given our global business, we earn our profits and hold assets in various currencies. The translation of those into our reporting currency exposes us to movements in foreign exchange rates.

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Our main investment risk exposure arises from the portion of the profits from the UK with-profits fund to which we are entitled to receive; the value of the future fees from our fee-earning products in our Asia business; and from the asset returns backing Jackson s variable annuities business.

Our interest rate risk is driven in the UK by our need to match our assets and liabilities; from the guarantees of some non unit-linked investment products in Asia; and the cost of guarantees in Jackson s fixed, fixed index and variable annuity business.

The methods that we use to manage and mitigate our market risks include the following:

- Our market risk policy;
- Risk appetite statements, limits and triggers that we have in place;
- The monitoring and oversight of market risks through the regular reporting of management information;
- Our asset and liability management programmes;
- Use of derivative programmes, including, for example, interest rate swaps, options and hybrid options for interest rate risk;
- Regular deep dive assessments; and
- Use of currency hedging.

Investment risk

In the UK business, our main investment risk arises from the assets held in the with-profits funds. Although this is mainly held by our policyholders, a proportion of the fund s profit (one tenth) is transferred to us and so our investment exposure relates to the future valuation of that proportion (future transfers). This investment risk is driven mainly by equities in the fund, although there is some risk associated with other investments such as property and bonds. Some hedging to protect from a reduction in the value of these future transfers against falls in equity prices is performed outside the fund using derivatives. The with-profits funds large Solvency II own funds estimated at £8.6 billion as at 30 June 2017 (31 December 2016: £8.4 billion) helps to protect against market fluctuations and helps the fund to maintain appropriate solvency levels. The with-profits funds Solvency II own funds are partially protected against falls in equity markets through an active hedging programme within the fund.

In Asia, our shareholder exposure to equity price movements results from unit-linked products, where our fee income is linked to the market value of the funds under management. Further exposure arises from with-profits businesses where bonuses declared are broadly based on historical and current rates of return on equity.

In Jackson, investment risk arises from the assets backing customer policies. In the case of spread-based business, including fixed annuities, these assets are generally bonds, and shareholder exposure comes from the minimum returns needed to meet the guaranteed rates that we offer to policyholders. For our variable annuity business, these assets include both equities and bonds. In this case, the main risk to the shareholder comes from the guaranteed benefits that can be included as part of these products. Our exposure to this kind of situation is reduced by using a derivative hedging programme, as well as through the use of reinsurance to pass on the risk to third party reinsurers.

Interest rate risk

While long-term interest rates in advanced economies have broadly increased since mid-2016 and indications are for further gradual tightening of monetary policy, they remain close to historical lows. Some products that we offer are sensitive to movements in interest rates. We have already taken a number of actions to reduce the risk to the in-force business, as well as re-pricing and restructuring new business offerings in response to these historically low interest rates. Nevertheless, we still retain some sensitivity to interest rate movements.

Interest rate risk arises in our UK business from the need to match cash payments to meet annuity obligations with the cash we receive from our investments. To minimise the impact on our profit, we aim to match the duration (a measure of interest rate sensitivity) of assets and liabilities as closely as possible and the position is monitored regularly. Under the Solvency II regulatory regime, additional interest rate risk results from the way the balance sheet is constructed, such as the requirement for us to include a risk margin. The UK business continually assesses the need for any derivatives in managing its interest rate sensitivity. The with-profits business is exposed to interest rate risk because of underlying guarantees in some of its products. Such risk is largely borne by the with-profits fund itself but shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

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In Asia, our exposure to interest rate risk arises from the guarantees of some non unit-linked investment products. This exposure exists because it may not be possible to hold assets which will provide cash payments to us which match exactly those payments we in turn need to make to policyholders this is known as an asset and liability mismatch and although it is small and appropriately managed, it cannot be eliminated.

Jackson is exposed to interest rate risk in its fixed, fixed index and variable annuity books. Movements in interest rates can impact on the cost of guarantees in these products, in particular the cost of guarantees may increase when interest rates fall. We actively monitor the level of sales of variable annuity products with guaranteed living benefits, and together with the risk limits we have in place this helps us to ensure that we are comfortable with the interest rate and market risks we incur as a result. The Jackson hedging programme includes hybrid derivatives to protect us from a combined fall in interest rates and equity markets since Jackson is exposed to the combination of these market movements.

Foreign exchange risk

The geographical diversity of our businesses means that we have some exposure to the risk of exchange rate fluctuations. Our operations in the US and Asia, which represent a large proportion of our operating profit and shareholders funds, generally write policies and invest in assets in local currencies. Although this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in our Group financial statements when results are reported in UK sterling.

We retain revenues locally to support the growth of our business and capital is held in the local currency of the business to meet local regulatory and market requirements. We accept the foreign exchange risk this can produce when reporting our Group balance sheet and income statement. In cases where a surplus arises in an overseas operation which is to be used to support Group capital, or where a significant cash payment is due from an overseas subsidiary to the Group, this foreign exchange exposure is hedged where we believe it is economically favourable to do so. Generally, we do not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside of the countries in which we operate, but we do have some controlled appetite for this on fee income and on non-sterling investments within the with-profits fund. Where foreign exchange risk arises outside our appetite, currency borrowings, swaps and other derivatives are used to manage our exposure.

b. Credit risk

We invest in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments we need to make to policyholders. We also enter into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, we are exposed to credit risk and counterparty risk across our business.

Credit risk is the potential for reduction in the value of our investments which results from the perceived level of risk of an investment issuer being unable to meet its obligations (defaulting). Counterparty risk is a type of credit risk and relates to the risk that the counterparty to any contract we enter into being unable to meet their obligations causing us to suffer loss.

We use a number of risk management tools to manage and mitigate this credit risk, including the following:

- Our credit risk policy;
- Risk appetite statements and limits that we have defined on issuers, and counterparties;

- Collateral arrangements we have in place for derivative, reverse repo and reinsurance transactions;
- The Group Credit Risk Committee s oversight of credit and counterparty credit risk and sector and/or name-specific reviews. In the first half of 2017 it has conducted sector reviews in the Asia sovereign sector and continues to review the developments around central clearing;
- Regular deep dive assessments; and
- Close monitoring or restrictions on investments that may be of concern.

Debt and loan portfolio

Our UK business is mainly exposed to credit risk on fixed income assets in the shareholder-backed portfolio. At 30 June 2017, this portfolio contained fixed income assets worth £35.4 billion. Credit risk arising from a further £55.9 billion of fixed income assets is largely borne by the with-profits fund, to which the shareholder is not directly exposed although under extreme circumstances shareholder support may be required if the fund is unable to meet payments as they fall due.

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The value of our debt portfolio in our Asia business was £39.1 billion at 30 June 2017. The majority (69 per cent) of the portfolio is in unit-linked and with-profits funds and so exposure of the shareholder to this component is minimal. The remaining 31 per cent of the debt portfolio is held to back the shareholder business.

Credit risk also arises in the general account of the Jackson business, where £38.0 billion of fixed income assets are held to support shareholder liabilities including those from our fixed annuities, fixed index annuities and life insurance products.

The shareholder-owned debt and loan portfolio of the Group s asset management business of £2.4 billion as at 30 June 2017 mostly belongs to our Prudential Capital (PruCap) operations.

Further details of the composition and quality of our debt portfolio, and exposure to loans, can be found in the IFRS financial statements.

Group sovereign debt

We also invest in bonds issued by national governments. This sovereign debt represented 17 per cent or £14.9 billion of the shareholder debt portfolio as at 30 June 2017 (31 December 2016: 19 per cent or £17.1 billion). 5 per cent of this was rated AAA and 90 per cent was considered investment grade (31 December 2016: 92 per cent investment grade). At 30 June 2017, the Group s shareholder holding in Eurozone sovereign debt[1] was £844 million. 77 per cent of this relates to German government debt[2] (31 December 2016: 75 per cent).

The particular risks associated with holding sovereign debt are detailed further in our disclosures on risk factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 30 June 2017 are given in Note C3.2(f) of the Group s IFRS financial statements.

Bank debt exposure and counterparty credit risk

Our exposure to banks is a key part of our core investment business, as well as being important for the hedging and other activities we undertake to manage our various financial risks. Given the importance of our relationship with our banks, exposure to the sector is considered a key risk for the Group with an appropriate level of management information provided to the Group s risk committees and the Board.

The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 30 June 2017 are given in Note C3.2(f) of the Group s IFRS financial statements.

Our exposure to derivative counterparty and reinsurance counterparty credit risk is managed using an array of risk management tools, including a comprehensive system of limits.

Where appropriate, we reduce our exposure, buy credit protection or use additional collateral arrangements to manage our levels of counterparty credit risk.

At 30 June 2017, shareholder exposures by rating and sector are shown below:

96 per cent of the shareholder portfolio is investment grade rated. In particular, 69 per cent of the portfolio is rated A and above; and

The Group s shareholder portfolio is well diversified: no individual sector makes up more than 10 per cent of the total portfolio (excluding the financial and sovereign sectors).

c. Liquidity risk

Our liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due. This incorporates the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or redemption requests are made against Prudential issued illiquid funds.

We have significant internal sources of liquidity, which are sufficient to meet all of our expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external

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sources of funding. In total, the Group has £2.6 billion of undrawn committed facilities that we can make use of, £2.4 billion of which expire in 2022 and £0.2 billion in 2021. We have access to further liquidity by way of the debt capital markets, and also have in place an extensive commercial paper programme and have maintained a consistent presence as an issuer in this market for the last decade.

Liquidity uses and sources are assessed at a Group and business unit level under both base case and stressed assumptions. We calculate a Liquidity Coverage Ratio (LCR) under stress scenarios as one measure of our liquidity risk, and this ratio and the liquidity resources available to us are regularly monitored and are assessed to be sufficient.

Our risk management and mitigation of liquidity risk include:

- Our liquidity risk policy;
- The risk appetite statements, limits and triggers that we have in place;
- The monitoring of liquidity risk we perform through regular management information to committees and the Board;
- Our Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as gap analysis of our liquidity risks and the adequacy of our available liquidity resources under normal and stressed conditions;
- Regular stress testing;
- Our established contingency plans and identified sources of liquidity;
- Our ability to access the money and debt capital markets;
- Regular deep dive assessments; and
- The access we enjoy to external sources of finance through committed credit facilities.

4.2 Risks from our products

a. Insurance risk

Insurance risk makes up a significant proportion of our overall risk exposure. The profitability of our businesses depends on a mix of factors including levels of, and trends in, mortality (policyholders dying), morbidity (policyholders becoming ill) and persistency (customers lapsing their policies), and increases in the costs of claims, including the level of medical expenses increases over and above price inflation (claim inflation).

The key drivers of the Group s insurance risks are persistency and morbidity risk in the Asia business; and longevity risk in the Jackson and Prudential UK & Europe businesses.

We manage and mitigate our insurance risk using the following:

- Our insurance and underwriting risk policies;
- The risk appetite statements, limits and triggers we have in place;
- Using longevity, morbidity and persistency assumptions that reflect recent experience and expectation of future trends, and industry data and expert judgement where appropriate;
- We use reinsurance to mitigate longevity and morbidity risks;
- Morbidity risk is also mitigated by appropriate underwriting when policies are issued and claims are received;
- Persistency risk is mitigated through the quality of sales processes and with initiatives to increase customer retention;
- Medical expense inflation risk mitigated through product re-pricing; and

Regular deep dive assessments.

Longevity risk is an important element of our insurance risks for which we need to hold a large amount of capital under Solvency II regulations. Longevity reinsurance is a key tool for us in managing our risk. The enhanced pensions freedoms introduced in the UK during 2015 greatly reduced the demand for retail annuities and further liberalisation is anticipated. Although we have scaled down our participation in the annuity market by reducing new business acquisition, given our significant annuity portfolio the assumptions we make about future rates of improvement in mortality rates remain key to the measurement of our insurance liabilities and to our assessment of any reinsurance transactions.

We continue to conduct research into longevity risk using both experience from our annuity portfolio and industry data. Although the general consensus in recent years is that people are living longer, there is considerable

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volatility in year-on-year longevity experience, which is why we need expert judgement in setting our longevity basis.

Our morbidity risk is mitigated by appropriate underwriting when policies are issued and claims are received. Our morbidity assumptions reflect our recent experience and expectation of future trends for each relevant line of business.

In Asia, we write significant volumes of health protection business, and so a key assumption for us is the rate of medical inflation, which is often in excess of general price inflation. There is a risk that the expenses of medical treatment increase more than we expect, so the medical claim cost passed on to us is higher than anticipated. Medical expense inflation risk is best mitigated by retaining the right to re-price our products each year and by having suitable overall claim limits within our policies, either limits per type of claim or in total across a policy.

Our persistency assumptions similarly reflect a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. Persistency risk is mitigated by appropriate training and sales processes and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, we make allowance for the relationship (either assumed or historically observed) between persistency and investment returns and account for the resulting additional risk. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products. The effect of persistency on our financial results can vary but mostly depends on the value of the product features and market conditions.

4.3 Risks from our business operations

a. Operational risk

Operational risk is the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel and systems, or from external events. This includes employee error, model error, system failures, fraud or some other event which disrupts business processes.

We manage and mitigate our operational risk using the following:

- Operational risk and outsourcing and third-party supply policies;
- Corporate insurance programmes to limit the impact of operational risks;
- Scenario analysis for operational risk capital requirements, which focus on extreme, yet plausible, events;
- Internal and external review of cyber security capability;
- Regular testing of elements of the disaster-recovery plan;
- Group and Business Unit level Compliance oversight and testing in respect of adherence with in-force regulations; and
- Regulatory change teams in place assist the business in proactively adapting and complying with regulatory developments.

An important element of operational risk relates to compliance with changing regulatory requirements. The high rate of global regulatory change, in an already complex regulatory landscape, increases the risk of non-compliance due to a failure to identify, correctly interpret, implement and/or monitor regulations. Legislative developments over recent years, together with enhanced regulatory oversight and increased capability to issue sanctions, have resulted in a complex regulatory environment that may lead to breaches of varying magnitude if the Group s business-as-usual operations are not compliant. As well as prudential regulation, we focus on conduct regulation, including regulations related to anti-money laundering, bribery and corruption, and sales practices. We have a particular focus on these regulations in newer/emerging markets.

The performance of core activities places reliance on the IT infrastructure that supports day-to-day transaction processing. Our IT environment must also be secure and we must address an increasing cyber risk threat as our digital footprint increases see separate Cyber risk section below. The risk that our IT infrastructure does not meet these requirements is a key area of focus, particularly the risk that legacy IT infrastructure supporting core activities/processes affects business continuity or impacts on business growth.

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Addressing these key risks requires change and transformation activities in order for Prudential to meet the expectations of its stakeholders, regulators, customers and shareholders, as well as to maintain market competitiveness in an industry where innovation is steadily accelerating. There are financial and reputational implications if such activities fail (either wholly or in part) to meet its objectives, and even if successful there is a potential to alter Prudential s operational risk profile. Owing to these factors, the execution and implications of internal change activities is an important area of focus.

As well as the above, other key areas of focus within operational risk include:

- The risk of a significant failure of a third-party outsourcing partner impacting critical services;
- The risk of trading or transaction errors having a material cost across Group;
- The risk that errors within models and user-developed applications used by the Group result in incorrect or inappropriate transactions being instructed;
- Departure of key persons or teams resulting in disruption to current and planned business activities;
- The risk that key people, processes and systems are unable to operate (thus impacting on the on-going operation of the business) due to a significant unexpected external event; for example pandemic, terrorist attack, natural disaster or political unrest; and
- The risk of inadequate or inappropriate controls, governance structures or communication channels in place to support the desired culture and ensure that the business is managed in line with the core business values, within the established risk appetite and in alignment with external stakeholder expectations.

b. Global regulatory and political risk

Our risk management and mitigation of regulatory and political risk includes the following:

- Risk Assessment of the Business Plan which includes consideration of current strategies;
- Close monitoring and assessment of our business environment and strategic risks;
- Board strategy sessions that consider risk themes;
- A Systemic Risk Management Plan that details the Group s strategy and Risk Management Framework; and
- A Recovery Plan covering corporate and risk governance for managing risks in a distressed environment, a range of recovery options, and scenarios to assess the effectiveness of these recovery options.

On 29 March 2017 the UK submitted formal notification of its intention to withdraw from the EU. The potential outcome of the negotiations on UK withdrawal and any subsequent negotiations on trade and access to major trading markets, including the single EU market, is currently highly uncertain. Following submission of this notification, the UK has a period of two years to negotiate the terms of its withdrawal from the EU. If no formal withdrawal agreement is reached then it is expected the UK s membership of the EU will automatically terminate two years after the submission of the notification.

The ongoing uncertainty and likelihood of a lengthy negotiation period may increase volatility in the markets where we operate, creating the potential for a general downturn in economic activity and for further or prolonged falls in interest rates in some jurisdictions due to easing of monetary policy and investor sentiment. We have several UK-domiciled operations, including Prudential UK and M&G, and these may be impacted by a UK withdrawal from the EU. However, our diversification by geography, currency, product and distribution should reduce some of the potential impact. Contingency plans were developed ahead of the referendum by business units and operations that may be immediately impacted by a vote to withdraw the UK from the EU, and these plans have been enacted since the referendum result.

The UK s decision to leave the EU has the potential to result in changes to future applicability of the Solvency II regime in the UK. The European Commission has commenced a review of some elements of the application of the Solvency II legislation with a particular focus on the Solvency Capital Requirement calculated using the standard formula.

National and regional efforts to curb systemic risk and promote financial stability are also underway in certain jurisdictions in which Prudential operates, including the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US, and other European Union legislation related to the financial services industry, such as MiFID2.

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There are a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way Prudential is supervised. These include addressing Financial Conduct Authority (FCA) reviews, ongoing engagement with the Prudential Regulation Authority (PRA), and the work of the Financial Stability Board (FSB) and standard-setting institutions such as the International Association of Insurance Supervisors (IAIS). Decisions taken by regulators, including those related to solvency requirements, corporate or governance structures, capital allocation and risk management may have an impact on our business.

The IAIS s Global Systematically Important Insurers (G-SII) regime form additional compliance considerations for us. Groups designated as G-SIIs are subject to additional regulatory requirements, including enhanced group-wide supervision, effective resolution planning, development of a Systemic Risk Management Plan, a Recovery Plan and a Liquidity Risk Management Plan. Prudential s designation as a G-SII was reaffirmed by the IAIS in November 2016, based on the updated methodology published in June 2016. Prudential is monitoring the development and potential impact of the policy measures and is continuing to engage with the PRA on the implications of the policy measures and Prudential s designation as a G-SII. The IAIS is intending to review the G-SII designation methodology, including considering the activity based designation methodology in 2019.

We continue to engage with the IAIS on developments in capital requirements for groups with G-SII designation. The regime introduces capital requirements in the form of a Higher Loss Absorption (HLA) requirement. While this requirement was initially intended to come into force in 2019, this has now been postponed to 2022. The HLA is also now intended to be based on the Insurance Capital Standard (ICS), which is being developed by the IAIS as the capital requirements under the its Common Framework (ComFrame). This framework is focused on the supervision of Internationally Active Insurance Groups and will establish a set of common principles and standards designed to assist regulators in addressing risks that arise from insurance groups with operations in multiple jurisdictions. As part of this, work is underway to develop a global Insurance Capital Standard that is intended to apply to Internationally Active Insurance Groups.

A consultation on the ICS was concluded in 2016 and the IAIS intends to publish an interim version of ICS in 2017. Further field testing, consultations and private reporting to group-wide supervisors on the interim version of the ICS are expected over the coming years. It is currently planned to be adopted as part of ComFrame by the IAIS in late 2019.

The IAIS s Insurance Core Principles, which provide a globally-accepted framework for the supervision of the insurance sector and ComFrame evolution, are expected to create continued development in both prudential and conduct regulations over the next two to three years.

In the US, the Department of Labor rule became effective on 9 June 2017 (although some provisions do not come into effect until January 2018), and introduces new fiduciary obligations for distributors of investment products to holders of regulated accounts, which may dramatically reshape the distribution of retirement products. Jackson s strong relationships with distributors, history of product innovation and efficient operations should help mitigate any impacts.

The US National Association of Insurance Commissioners (NAIC) is currently conducting an industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and risk management. Following an industry quantitative impact study, changes have been proposed to the current framework; however, these are considered to be at an early stage of development. Jackson continues to be engaged in the consultation and testing process. The proposal is expected to be effective from 2019 at the earliest.

With the new US administration having taken office in January 2017, the potential uncertainty as to the timetable and status of these key US reforms has increased given preliminary indications from Washington. Our preparations to manage the impact of these reforms will continue until further clarification is provided.

In May 2017, the International Accounting Standards Board (IASB) published IFRS 17 which will introduce fundamental changes to the statutory reporting of insurance entities that prepare accounts according to IFRS from 2021. We are currently considering the potential impact of the complex requirements of this standard on the Group which can be expected to, amongst other things, alter the timing of IFRS profit recognition.

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In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New requirements could be introduced in these and other regulatory regimes that challenge legal or ownership structures, current sales practices, or could retrospectively be applied to sales made prior to their introduction, which could have a negative impact on Prudential s business or reported results.

c. Cyber risk

Cyber risk is an area of increased scrutiny for global regulators after a number of recent high profile attacks and data losses. The growing maturity and industrialisation of cyber-criminal capability, together with an increasing level of understanding of complex financial transactions by criminal groups, are two reasons why risks to the financial services industry are increasing. Developments in data protection worldwide (such as the EU General Data Protection Regulation that is expected to come into force in 2018) may increase the financial and reputational implications for Prudential on a breach of its IT systems.

Given this, cyber security is seen as a key risk for the Group. Our current threat assessment is that, while we are not individually viewed as a compelling target for a direct cyber-attack, there have been recent changes to the threat landscape and the risk from untargeted but sophisticated and automated attacks has increased, as has the risk stemming from geopolitical tensions. These have the potential to significantly impact on business continuity, our customer relationship and our brand reputation.

The Board receives periodic updates on cyber risk management throughout the year. The current Group-wide Cyber Risk Management Strategy and the associated Group-wide Coordinated Cyber Defence Plan were approved by the Board in 2016.

The Cyber Risk Management Strategy includes three core objectives: to develop a comprehensive situational awareness of our business in cyberspace, to pro-actively engage cyber attackers to minimise harm to our business and to enable the business to grow confidently and safely in cyberspace.

The Cyber Defence Plan consists of a number of work-streams, including developing our ability to deal with incidents; alignment with our digital transformation strategy; and increasing cyber oversight and assurance to the Board.

Protecting our customers remains core to our business, and the successful delivery of the Cyber Defence Plan will reinforce our capabilities to continue doing so in cyberspace as we transition to a digital business.

Group functions work with each of the business units to address cyber risks locally within the national and regional context of each business, following the strategic direction laid out in the Cyber Risk Management Strategy and managed through the execution of the Cyber Defence Plan.

The Group Information Security Committee, which consists of senior executives from each of the businesses and meets on a regular basis, governs the execution of the Cyber Defence Plan and reports on delivery and cyber risks to the Group Executive Risk Committee. Both committees also receive regular operational management information on the performance of controls.

1.

Excludes Group s proportionate share in joint ventures and associates and unit-linked assets and holdings of consolidated unit trust and similar funds.

2. Including bonds guaranteed by the federal government.

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Risk Factors

A number of risk factors affect Prudential s operating results and financial condition and, accordingly, the trading price of its shares. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The information given is as of the date of this document, and any forward-looking statements are made subject to the reservations specified under Forward-Looking Statements .

Risks relating to Prudential s business

Prudential s businesses are inherently subject to market fluctuations and general economic conditions

Uncertainty or negative trends in international economic and investment climates could adversely affect Prudential s business and profitability. Prudential operates against a challenging background of periods of significant uncertainty and volatility in global capital and equity markets and interest rates (which in some jurisdictions are negative), together with widespread economic uncertainty. For example, government interest rates remain at or near historic lows in the US, the UK and some Asian countries in which Prudential operates. These factors could have a material adverse effect on Prudential s business and profitability.

In the future, the adverse effects of such factors would be felt principally through the following items:

- Investment impairments and/or reduced investment returns, which could reduce Prudential s capital and impair its ability to write significant volumes of new business, increase the potential adverse impact of product guarantees, or have a negative impact on its assets under management and profit;
- Higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses;
- Failure of counterparties who have transactions with Prudential (eg banks and reinsurers) to meet commitments that could give rise to a negative impact on Prudential s financial position and on the accessibility or recoverability of amounts due or, for derivative transactions, adequate collateral not being in place;
- Estimates of the value of financial instruments being difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain such values require substantial elements of judgement, assumptions and estimates (which may change over time); and
- Increased illiquidity also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline. For example, this could occur where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or redemption restrictions are placed on Prudential s investments in illiquid funds. In addition, significant redemption requests could also be made on Prudential s issued funds and while this may not have a direct impact on the Group s liquidity, it could result in reputational damage to Prudential.

Global financial markets are subject to uncertainty and volatility created by a variety of factors, including concerns over: the expected change in accommodative monetary policies in the US, the UK and other jurisdictions with the risk of a disorderly repricing of inflation expectations and global bond yields, sovereign debt, a general slowing in world growth, the increased level of geopolitical risk and policy-related uncertainty and potentially negative socio-political events.

On 29 March 2017 the UK submitted the formal notification of its intention to withdraw from the EU pursuant to Article 50 of the Treaty on the European Union, as amended. Following submission of this notification, the UK has a maximum period of two years to negotiate the terms of its withdrawal from the EU. If no formal withdrawal agreement is reached between the UK and the EU, then it is expected the UK s membership of the EU will automatically terminate two years after the submission of the notification of the UK s intention to withdraw from the

EU. The UK s decision to leave the EU will have political, legal and economic ramifications for both the UK and the EU, although these are expected to be more pronounced for the UK. The Group has several UK domiciled operations, including Prudential UK and M&G, and these may be impacted by a UK withdrawal from the EU. The potential outcome of the negotiations on UK withdrawal and any subsequent negotiations on trade and access to the country s major trading markets, including the single EU market, is currently unknown. The ongoing uncertainty of when the UK will leave the EU, whether any form of transitional arrangements will be agreed between the UK and the EU, and the possibility of a lengthy period before negotiations are concluded may increase volatility in the markets where the Group operates and create the potential for a general downturn in economic activity and for further or prolonged interest rate reductions in some jurisdictions due to monetary easing and investor sentiment.

More generally, upheavals in the financial markets may affect general levels of economic activity, employment and customer behaviour. As a result, insurers may experience an elevated incidence of claims, lapses, or surrenders of policies, and some policyholders may choose to defer or stop paying insurance premiums. The demand for insurance products may also be adversely affected. In addition, there may be a higher incidence of counterparty failures. If sustained, this environment is likely to have a negative impact on the insurance sector over time and may consequently have a negative impact on Prudential s business and its balance sheet and profitability. For example, this could occur if the recoverable value of intangible assets for bancassurance agreements and deferred acquisition costs are reduced. New challenges related to market fluctuations and general economic conditions may continue to emerge.

For some non-unit-linked investment products, in particular those written in some of the Group s Asian operations, it may not be possible to hold assets which will provide cash flows to match those relating to policyholder liabilities. This is particularly true in those countries where bond markets are not developed and in certain markets where regulated premium and claim values are set with reference to the interest rate environment prevailing at the time of policy issue. This results in a mismatch due to the duration and uncertainty of the liability cash flows and the lack of sufficient assets of a suitable duration. While this residual asset/liability mismatch risk can be managed, it cannot be eliminated. Where interest rates in these markets remain lower than those used to calculate premium and claim values over a sustained period, this could have a material adverse effect on Prudential s reported profit.

In the US, fluctuations in prevailing interest rates can affect results from Jackson which has a significant spread-based business, with the significant proportion of its assets invested in fixed income securities. In particular, fixed annuities and stable value products written by Jackson expose Prudential to the risk that changes in interest rates, which are not fully reflected in the interest rates credited to customers, will reduce spread. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the policyholders liabilities and the amounts that are credited to policyholders in the form of benefit increases, subject to minimum crediting rates. Declines in spread from these products or other spread businesses that Jackson conducts, and increases in surrender levels arising from interest rate rises, could have a material impact on its businesses or results of operations.

Jackson also writes a significant amount of variable annuities that offer capital or income protection guarantees. The value of these guarantees is affected by market factors (such as interest rates, equity values, bond spreads and realised volatility) and policyholder behaviour. Jackson manages its exposure to market risks arising on these guarantees by using a derivative hedging programme. However, there could be market circumstances where the derivatives that Jackson enters into to hedge its market risks may not fully cover its exposures under the guarantees. The cost of the guarantees that remain unhedged will also affect Prudential s results.

In addition, Jackson hedges the guarantees on its variable annuity book on an economic basis (with consideration of the local regulatory position) and, thus, accepts variability in its accounting results in the short term in order to achieve the appropriate result on these bases. In particular, for Prudential s Group IFRS reporting, the measurement of the Jackson variable annuity guarantees is typically less sensitive to market movements than for the corresponding hedging derivatives, which are held at market value. However, depending on the level of hedging conducted regarding a particular risk type, certain market movements can drive volatility in the economic or local regulatory results that may be less significant under IFRS reporting.

A significant part of the profit from Prudential s UK insurance operations is related to bonuses for policyholders declared on with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential s expectations of future investment returns. This profit could be lower in a sustained low interest rate environment.

Prudential is subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio

Investing in sovereign debt creates exposure to the direct or indirect consequences of political, social or economic changes (including changes in governments, heads of state or monarchs) in the countries in which the issuers are located and the creditworthiness of the sovereign. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. In addition, the issuer of the debt or the governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or pay interest when due in accordance with the terms of such debt, and Prudential may have limited recourse to compel payment in the event of a default. A sovereign debtor s willingness or ability to repay principal and to pay interest in a timely manner may be affected by, among other factors, its cash flow situation, its relations with its central bank, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor s policy toward local and international lenders, and the political constraints to which the sovereign debtor may be subject.

Moreover, governments may use a variety of techniques, such as intervention by their central banks or imposition of regulatory controls or taxes, to devalue their currencies exchange rates, or may adopt monetary and other policies (including to manage their debt burdens) that have a similar effect, all of which could adversely impact the value of an investment in sovereign debt even in the absence of a technical default. Periods of economic uncertainty may affect the volatility of market prices of sovereign debt to a greater extent than the volatility inherent in debt obligations of other types of issuers.

In addition, if a sovereign default or other such events described above were to occur, other financial institutions may also suffer losses or experience solvency or other concerns, and Prudential might face additional risks relating to any debt of such financial institutions held in its investment portfolio. There is also risk that public perceptions about the stability and creditworthiness of financial institutions and the financial sector generally might be affected, as might counterparty relationships between financial institutions. If a sovereign were to default on its obligations, or adopted policies that devalued or otherwise altered the currencies in which its obligations were denominated this could have a material adverse effect on Prudential s financial condition and results of operations.

Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses

Due to the geographical diversity of Prudential s businesses, Prudential is subject to the risk of exchange rate fluctuations. Prudential s operations in the US and Asia, which represent a significant proportion of operating profit based on longer-term investment returns and shareholders funds, generally write policies and invest in assets denominated in local currencies. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential s consolidated financial statements upon the translation of results into pounds sterling. This exposure is not currently separately managed. The currency exposure relating to the translation of reported earnings could impact on financial reporting ratios such as dividend cover, which is calculated as operating profit after tax on an IFRS basis, divided by the dividends relating to the reporting year. The impact of gains or losses on currency translations is recorded as a component of shareholders funds within other comprehensive income. Consequently, this could impact on Prudential s gearing ratios (defined as debt over debt plus shareholders funds). The Group s surplus capital position for regulatory reporting purposes may also be affected by fluctuations in exchange rates with possible consequences for the degree of flexibility the Prudential has in managing its business.

Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations and any accounting standards in the markets in which it operates

Changes in government policy and legislation (including in relation to tax and capital controls), regulation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates, and decisions taken by regulators in connection with their supervision of members of the

Group, which in some circumstances may be applied retrospectively, may adversely affect Prudential s product range, distribution channels, competitiveness, profitability, capital requirements, risk management approaches, corporate or governance structure and, consequently, reported results and financing requirements. Also, regulators in jurisdictions in which Prudential operates may impose requirements affecting the allocation of capital and liquidity between different business units in the Group, whether on a geographic, legal entity, product line or other basis. Regulators may change the level of capital required to be held by individual businesses or could introduce possible changes in the regulatory framework for pension arrangements and policies, the regulation of selling practices and solvency requirements. In addition, there could be changes to the maximum level of non-domestic ownership by foreign companies in certain jurisdictions. Furthermore, as a result of interventions by governments in response to recent financial and global economic conditions, it is widely expected that there will continue to be a substantial increase in government regulation and supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transactions and enhanced supervisory powers.

The European Union s Solvency II Directive came into effect on 1 January 2016. This measure of regulatory capital is more volatile than under the previous Solvency I regime and regulatory policy may evolve under the new regime. The European Commission has in late 2016 begun a review of some aspects of the Solvency II legislation, which is expected to continue until 2021 and covers, among other things, a review of the Long Term Guarantee measures. Prudential applied for, and has been granted approval by the UK Prudential Regulation Authority to use the following measures when calculating its Solvency II capital requirements: the use of an internal model, the matching adjustment for UK annuities, the volatility adjustment for selected US Dollar-denominated business, and UK transitional measures. Prudential also has permission to use deduction and aggregation as the method by which the contribution of the Group s US insurance entities to the Group s solvency is calculated, which in effect recognises surplus in US insurance entities in excess of 250 per cent of local US Risk Based Capital requirements. There is a risk that in the future changes are required to be made to the approved internal model and these related applications which could have a material impact on the Group Solvency II capital position. Where internal model changes are subject to regulatory approval, there is a risk that the approval is delayed or not given. In such circumstances, changes in our risk profile would not be able to be appropriately reflected in our internal model, which could have a material impact on the Group s Solvency II capital position. The UK s decision to leave the EU could result in significant changes to the regulatory regime under which the Group operates.

Currently there are also a number of other global regulatory developments which could impact the way in which Prudential is supervised in its many jurisdictions. These include the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in the US, the work of the Financial Stability Board (FSB) on Global Systemically Important Insurers (G-SIIs) and the proposed amendments to Markets in Financial Instruments Directive (the MiFID2 Directive) in the EU. In addition, regulators in a number of jurisdictions in which the Group operates are further developing local capital regimes; this includes potential future developments in Solvency II in the UK (as referred to above), National Association of Insurance Commissioners reforms in the US, and amendments to certain local statutory regimes in some territories in Asia. These changes and their potential impact on the Group remain uncertain.

The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the US including reforms to financial services entities, products and markets. The full impact of the Dodd-Frank Act on Prudential s businesses remains unclear, as many of its provisions are primarily focused on the banking industry, have a delayed effectiveness and/or require rulemaking or other actions by various US regulators over the coming years. There is also uncertainty surrounding future changes to the Dodd-Frank Act.

Prudential s designation as a G-SII was reaffirmed on 21 November 2016. As a result of this designation, Prudential is subject to additional regulatory requirements, including a requirement to submit enhanced risk management plans (such as a Group-wide Recovery Plan, a Systemic Risk Management Plan and a Liquidity Risk Management Plan) to a Crisis Management Group (CMG) comprised of an international panel of regulators.

The G-SII regime also introduces capital requirements in the form of a Higher Loss Absorption (HLA) requirement. While this requirement was initially intended to come into force in 2019, this has now been postponed to 2022. The HLA is also now intended to be based on the Insurance Capital Standard (ICS). This is being developed by the IAIS as the Pillar 1 capital requirement under ComFrame to be applied for Internationally Active Insurance Groups

(IAIGs), with a target to finalise a version for implementation in 2019. (ComFrame will more generally establish a set of common principles and standards designed to assist regulators in addressing risks that arise from insurance groups with operations in multiple jurisdictions.)

Various jurisdictions in which Prudential operates have created investor compensation schemes that require mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant in the majority of its chosen markets, circumstances could arise where Prudential, along with other companies, may be required to make such contributions.

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The Group s accounts are prepared in accordance with current International Financial Reporting Standards (IFRS) applicable to the insurance industry. The International Accounting Standards Board (IASB) introduced a framework that it described as Phase I which, under its standard IFRS 4 permitted insurers to continue to use the statutory basis of accounting for insurance assets and liabilities that existed in their jurisdictions prior to January 2005. In May 2017, the IASB published its replacement standard on insurance accounting (IFRS 17, Insurance Contracts), which will have the effect of introducing fundamental changes to the statutory reporting of insurance entities that prepare accounts according to IFRS from 2021. The European Union will apply its usual process for assessing whether the standard meets the necessary criteria for endorsement. With the publication of IFRS 17, the Group is familiarising itself with the complex requirements of this standard and considering its potential impact. The effect of changes required to the Group s accounting policies as a result of implementing the new standard is currently uncertain, but these changes can be expected to, amongst other things, alter the timing of IFRS profit recognition.

Any changes or modification of IFRS accounting policies may require a change in the way in which future results will be determined and/or a retrospective adjustment of reported results to ensure consistency.

The resolution of several issues affecting the financial services industry could have a negative impact on Prudential s reported results or on its relations with current and potential customers

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally. This risk could arise from the application of current regulations or the failure to implement new regulations. These actions could involve a review of types of business sold in the past under acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pensions and mortgage endowment policies, changes to the tax regime affecting products, and regulatory reviews on products sold and industry practices, including, in the latter case, lines of business it has closed. Current regulatory actions include the UK business s undertaking to the Financial Conduct Authority to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers and potentially provide redress to certain such customers.

Regulators interest may also include the approach that product providers use to select third party distributors and to monitor the appropriateness of sales made by them. In some cases, product providers can be held responsible for the deficiencies of third-party distributors.

In the US, there has been significant attention on the different regulatory standards applied to investment advice delivered to retail customers by different sectors of the industry. As a result of reports relating to perceptions of industry abuses, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms. This includes focus on the suitability of sales of certain products, alternative investments and the widening of the circumstances under which a person or entity providing investment advice with respect to certain employee benefit and pension plans would be considered a fiduciary (subjecting the person or entity to certain regulatory requirements, such as those adopted by the US Department of Labor issued in April 2016 which is likely to cause market disruption in the shorter term). There is a risk that new regulations introduced may have a material adverse effect on the sales of the products by Prudential and increase Prudential s exposure to legal risks.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New requirements could be introduced in these and other regulatory regimes that challenge legal structures, current sales practices, or could retrospectively be applied to sales made prior to their introduction, which could have a negative impact on Prudential s business or reported results.

Litigation, disputes and regulatory investigations may adversely affect Prudential s profitability and financial condition

Prudential is, and may be in the future, subject to legal actions, disputes and regulatory investigations in various contexts, including in the ordinary course of its insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of Prudential s businesses and operations that are specific to Prudential, or that are common to companies that operate in Prudential s markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by

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Prudential, and may be class actions. Although Prudential believes that it has adequately provided in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such provisions are sufficient. Given the large or indeterminate amounts of damages sometimes sought, other sanctions that might be applicable and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on Prudential s reputation, results of operations or cash flows.

Prudential s businesses are conducted in highly competitive environments with developing demographic trends and continued profitability depends upon management s ability to respond to these pressures and trends

The markets for financial services in the UK, US and Asia are highly competitive, with several factors affecting Prudential s ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, the ability to respond to developing demographic trends and customer appetite for certain savings products. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential s potential to grow its business as quickly as planned.

In Asia, the Group s principal competitors in the region are international financial companies, including global life insurers such as Allianz, AXA, AIA and Manulife, and multinational asset managers such as J.P. Morgan Asset Management, Schroders, HSBC Global Asset Management, and Franklin Templeton. In a number of markets, local companies have a very significant market presence.

Within the UK, Prudential s principal competitors include many of the major retail financial services companies and fund management companies including, in particular, Aviva, Legal & General, Standard Life, Schroders, Invesco Perpetual, and Fidelity.

Jackson s competitors in the US include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies such as AIG, AXA Financial Inc., Allianz, Prudential Financial, MetLife, and Aegon.

Prudential believes competition will intensify across all regions in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors. Prudential s ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures.

Downgrades in Prudential s financial strength and credit ratings could significantly impact its competitive position and damage its relationships with creditors or trading counterparties

Prudential s financial strength and credit ratings, which are used by the market to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in Prudential s products, and as a result its competitiveness. Downgrades in Prudential s ratings, as a result of, for example, decreased profitability, increased costs, increased indebtedness or other concerns, could have an adverse effect on its ability to market products; retain current policyholders; and on the Group s financial flexibility. In addition, the interest rates Prudential pays on its borrowings are affected by its credit ratings, which are in place to measure the Group s ability to meet its contractual obligations.

Prudential plc s long-term senior debt is rated as A2 by Moody s, A+ by Standard & Poor s, and A by Fitch. These ratings are all on a stable outlook.

Prudential plc s short-term debt is rated as P-1 by Moody s, A-1 by Standard & Poor s, and F1 by Fitch.

The Prudential Assurance Company Limited s financial strength is rated Aa3 by Moody s, AA by Standard & Poor s, and AA by Fitch. These ratings are all on a stable outlook.

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Jackson s financial strength is rated AA by Standard & Poor s and Fitch, A1 by Moody s, and A+ by AM Best. These ratings have a stable outlook.

Prudential Assurance Co. Singapore (Pte) Ltd s financial strength is rated AA by Standard & Poor s. This rating is on a stable outlook.

In addition, changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or Prudential s financial condition.

Adverse experience in the operational risks inherent in Prudential s business could disrupt its business functions and have a negative impact on its results of operations

Operational risks are present in all of Prudential s businesses, including the risk (from both Prudential and its outsourcing partners) of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. Prudential s business is dependent on processing a large number of transactions across numerous and diverse products, and is subject to a range of evolving legal and regulatory regimes. In addition, Prudential also employs a large number of models and user developed applications in its processes. Further, because of the long-term nature of much of the Group s business, accurate records have to be maintained for significant periods.

These factors, among others, result in significant reliance on and require significant investment in information technology (IT), compliance and other operational systems, personnel and processes, requiring a number of change initiatives to be established across Prudential that may have material financial and reputational implications if such initiatives fail (either wholly or in part) to meet their objectives. In addition, Prudential outsources several operations, including a significant part of its UK back office and customer-facing functions as well as a number of IT functions, resulting in reliance upon the operational processing performance of its outsourcing partners.

Although Prudential s IT, compliance and other operational systems, models and processes incorporate controls designed to manage and mitigate the operational and model risks associated with its activities, there can be no assurance that such controls will always be effective. Due to human error among other reasons, operational and model risk incidents do happen periodically and no system or process can entirely prevent them although there have not been any material events to date. Prudential s legacy and other IT systems and processes, as with operational systems and processes generally, may be susceptible to failure or security breaches.

Such events could, among other things, harm Prudential s ability to perform necessary business functions, result in the loss of confidential or proprietary data (exposing it to potential legal claims and regulatory sanctions) and damage its reputation and relationships with its customers and business partners. Similarly, any weakness in administration systems (such as those relating to policyholder records or meeting regulatory requirements) or actuarial reserving processes could have a material adverse effect on its results of operations during the effective period.

Attempts by third parties to disrupt Prudential s IT systems could result in loss of trust from Prudential s customers, reputational damage and financial loss

Prudential and its business partners are increasingly exposed to the risk that third parties may attempt to disrupt the availability, confidentiality and integrity of its IT systems, which could result in disruption to the key operations, make it difficult to recover critical services, damage assets and compromise the integrity and security of data (both corporate and customer). This could result in loss of trust from Prudential s customers, reputational damage and direct or indirect financial loss. The cyber-security threat continues to evolve globally in sophistication and potential significance. Prudential s increasing market profile, growing customer interest in interacting with their insurance providers and asset managers through the internet and social media, improved brand awareness and the classification of Prudential as a G-SII could also increase the likelihood of Prudential being considered a target by cyber criminals. Further, there have been recent changes to the threat landscape and the risk from untargeted but sophisticated and automated attacks has increased. Developments in data protection worldwide (such as the EU General Data Protection Regulation that is expected to come into force in 2018) may also increase the financial

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and reputational implications for Prudential following a significant breach of its IT systems. To date, Prudential has not identified a failure or breach which has had a material impact in relation to its legacy and other IT systems and processes. However, it has been, and likely will continue to be, subject to potential damage from computer viruses, attempts at unauthorised access and cyber-security attacks such as denial of service attacks (which, for example, can cause temporary disruption to websites and IT networks), phishing and disruptive software campaigns.

Prudential is continually enhancing its IT environment to remain secure against emerging threats, together with increasing its ability to detect system compromise and recover should such an incident occur. However, there can be no assurance that such events will not take place which may have material adverse consequential effects on Prudential s business and financial position.

Adverse experience relative to the assumptions used in pricing products and reporting business results could significantly affect Prudential s results of operations

In common with other life insurers, the profitability of the Group s businesses depends on a mix of factors including mortality and morbidity levels and trends, policy surrenders and take-up rates on guarantee features of products, investment performance and impairments, unit cost of administration and new business acquisition expenses.

Prudential needs to make assumptions about a number of factors in determining the pricing of its products, for setting reserves, and for reporting its capital levels and the results of its long-term business operations. For example, the assumption that Prudential makes about future expected levels of mortality is particularly relevant for its UK annuity business, where payments are guaranteed for at least as long as the policyholder is alive. Prudential conducts rigorous research into longevity risk, using industry data as well as its own substantial annuitant experience. As part of its pension annuity pricing and reserving policy, Prudential s UK business assumes that current rates of mortality continuously improve over time at levels based on adjusted data and informed by models from the Continuous Mortality Investigation (CMI) as published by the Institute and Faculty of Actuaries. Assumptions about future expected levels of mortality are also of relevance to the Guaranteed Minimum Withdrawal Benefit (GMWB) of Jackson s variable annuity business. If mortality improvement rates significantly exceed the improvement assumed, Prudential s results of operations could be adversely affected.

A further factor is the assumption that Prudential makes about future expected levels of the rates of early termination of products by its customers (known as persistency). This is relevant to a number of lines of business in the Group, especially for Jackson s portfolio of variable annuities. Prudential s persistency assumptions reflect a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. If actual levels of future persistency are significantly different than assumed, the Group s results of operations could be adversely affected. Furthermore, Jackson s variable annuity products are sensitive to other types of policyholder behaviour, such as the take-up of its GMWB product features.

Another example is the impact of epidemics and other effects that give rise to a large number of deaths or additional sickness claims. Significant influenza epidemics have occurred a number of times over the past century but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Group s loss experience.

As a holding company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments

The Group s insurance and investment management operations are generally conducted through direct and indirect subsidiaries, which are subject to the risks discussed elsewhere in this Risk Factors section.

As a holding company, Prudential s principal sources of funds are remittances from subsidiaries, shareholder-backed funds, the shareholder transfer from long-term funds and any amounts that may be raised through the issuance of equity, debt and commercial paper.

Certain of Prudential s subsidiaries are restricted by applicable insurance, foreign exchange and tax laws, rules and regulations that can limit remittances. In some circumstances, this could limit Prudential s ability to pay dividends to shareholders or to make available funds held in certain subsidiaries to cover operating expenses of other members of the Group.

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Prudential operates in a number of markets through joint ventures and other arrangements with third parties, involving certain risks that Prudential does not face with respect to its consolidated subsidiaries

Prudential operates, and in certain markets is required by local regulation to operate, through joint ventures and other similar arrangements. For such Group operations, management control is exercised in conjunction with other participants. The level of control exercisable by the Group depends on the terms of the contractual agreements, in particular, the allocation of control among, and continued cooperation between, the participants. Prudential may face financial, reputational and other exposure (including regulatory censure) in the event that any of its partners fails to meet its obligations under the arrangements, encounters financial difficulty, or fails to comply with local or international regulation and standards such as those pertaining to the prevention of financial crime. In addition, a significant proportion of the Group s product distribution is carried out through arrangements with third parties not controlled by Prudential and is therefore dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements, such as through significant deterioration in the reputation, financial position or other circumstances of the third party or material failure in controls (such as those pertaining to the prevention of financial crime) could adversely affect the results of operations of Prudential.

Prudential s Articles of Association contain an exclusive jurisdiction provision

Under Prudential s Articles of Association, certain legal proceedings may only be brought in the courts of England and Wales. This applies to legal proceedings by a shareholder (in its capacity as such) against Prudential and/or its directors and/or its professional service providers. It also applies to legal proceedings between Prudential and its directors and/or Prudential and Prudential s professional service providers that arise in connection with legal proceedings between the shareholder and such professional service provider. This provision could make it difficult for US and other non-UK shareholders to enforce their shareholder rights.

Changes in tax legislation may result in adverse tax consequences

Tax rules, including those relating to the insurance industry, and their interpretation may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its scope or interpretation could affect Prudential s financial condition and results of operations.

Prudential plc and subsidiaries

INDEX TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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Prudential plc and subsidiaries

Unaudited Condensed Consolidated Income Statements

	Note	2017 £m Half year	2016 £m Half year
Earned premiums, net of reinsurance		**21,158**	17,394
Investment return		**20,629**	17,062
Other income		**1,222**	1,085
Total revenue, net of reinsurance	B1.4	**43,009**	35,541
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance		**(35,442)**	(30,939)
Acquisition costs and other expenditure	B3	**(5,330)**	(3,563)
Finance costs: interest on core structural borrowings of shareholder-financed operations		**(216)**	(169)
Disposal of Korea life business:			
Cumulative exchange gain recycled from other comprehensive income	D1	**61**	**-**
Remeasurement adjustments	D1	**5**	**-**
Total charges, net of reinsurance		**(40,922)**	(34,671)
Share of profits from joint ventures and associates, net of related tax		**120**	86
Profit before tax *(being tax attributable to shareholders and policyholders returns)**		**2,207**	956
Less tax charge attributable to policyholders returns		**(393)**	(292)
Profit before tax attributable to shareholders	B1.1	**1,814**	664
Total tax charge attributable to policyholders and shareholders	B5	**(702)**	(269)
Adjustment to remove tax charge attributable to policyholders returns		**393**	292
Tax (charge) credit attributable to shareholders returns	B5	**(309)**	23
Profit for the period attributable to equity holders of the Company		**1,505**	687

Earnings per share (in pence)		**2017 Half year**	**2016 Half year**
Based on profit attributable to the equity holders of the Company:	B6		
Basic		**58.7p**	26.9p
Diluted		**58.6p**	26.8p

Dividends per share (in pence)	Note	**2017 Half year**	**2016 Half year**
Dividends relating to reporting period:	B7		
First interim ordinary dividend		**14.50p**	12.93p
Dividends paid in reporting period:	B7		
Second interim ordinary dividend for prior year		**30.57p**	26.47p

Special dividend for prior year	**-**	10.00p
Total	**30.57p**	36.47p

* This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.
This is because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure (which is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the PAC with-profits fund after adjusting for taxes borne by policyholders) is not representative of pre-tax profits attributable to shareholders.

The accompanying notes are an integral part of these financial statements

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Prudential plc and subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Income

	Note	2017 £m Half year	2016 £m Half year
Profit for the period		**1,505**	687
Other comprehensive income (loss):			
Items that may be reclassified subsequently to profit or loss			
Exchange movements on foreign operations and net investment hedges:			
Exchange movements arising during the period		**(220)**	798
Cumulative exchange gain of Korea life business recycled through profit and loss	D1	**(61)**	-
Related tax		**(4)**	8
		(285)	806
Net unrealised valuation movements on securities of US insurance operations classified as available-for-sale:			
Net unrealised holding gains arising during the period		**565**	2,023
Add back net losses (deduct net gains) included in the income statement on disposal and impairment		**(34)**	95
Total	C3.2(c)	**531**	2,118
Related change in amortisation of deferred acquisition costs	C5(b)	**(69)**	(435)
Related tax		**(162)**	(589)
		300	1,094
Total		**15**	1,900
Items that will not be reclassified to profit or loss			
Shareholders share of actuarial gains and losses on defined benefit pension schemes:			
Gross		**53**	11
Related tax		**(7)**	(2)
		46	9
Other comprehensive income for the period, net of related tax		**61**	1,909
Total comprehensive income for the period attributable to the equity holders of the Company		**1,566**	2,596

The accompanying notes are an integral part of these financial statements

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Prudential plc and subsidiaries

Unaudited Condensed Consolidated Statement Of Changes In Equity

		Period ended 30 June 2017 £m							
	Note	Share capital note C9	Share premium note C9	Retained earnings	Translation reserve	Available -for-sale securities reserves	Shareholders equity	Non- controlling interests	Total equity
Reserves									
Profit for the period		-	-	1,505	-	-	1,505	-	1,505
Other comprehensive income (loss)		-	-	46	(285)	300	61	-	61
Total comprehensive income (loss) for the period		-	-	1,551	(285)	300	1,566	-	1,566
Dividends	B7	-	-	(786)	-	-	(786)	-	(786)
Reserve movements in respect of share-based payments		-	-	22	-	-	22	-	22
Share capital and share premium									
New share capital subscribed	C9	-	10	-	-	-	10	-	10
Treasury shares									
Movement in own shares in respect of share-based payment plans		-	-	(12)	-	-	(12)	-	(12)
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		-	-	(17)	-	-	(17)	-	(17)
Net increase (decrease) in equity		-	10	758	(285)	300	783	-	783
At beginning of period		129	1,927	10,942	1,310	358	14,666	1	14,667
At end of period		129	1,937	11,700	1,025	658	15,449	1	15,450

The accompanying notes are an integral part of these financial statements

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Prudential plc and subsidiaries

Unaudited Condensed Consolidated Statement Of Changes In Equity (continued)

		Period ended 30 June 2016 £m							
						Available-for-sale		Non-	
		Share capital	**Share premium**	**Retained earnings**	**Translation reserve**	**securities reserves**	**Shareholders equity**	**controlling interests**	**Total equity**
	Note	note C9	note C9						
Reserves									
Profit for the period		-	-	687	-	-	687	-	687
Other comprehensive income		-	-	9	806	1,094	1,909	-	1,909
Total comprehensive income for the period		-	-	696	806	1,094	2,596	-	2,596
Dividends	B7	-	-	(935)	-	-	(935)	-	(935)
Reserve movements in respect of share-based payments		-	-	(54)	-	-	(54)	-	(54)
Share capital and share premium									
New share capital subscribed	C9	-	6	-	-	-	6	-	6
Treasury shares									
Movement in own shares in respect of share-based payment plans		-	-	22	-	-	22	-	22
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		-	-	15	-	-	15	-	15
Net increase (decrease) in equity		-	6	(256)	806	1,094	1,650	-	1,650
At beginning of period		128	1,915	10,436	149	327	12,955	1	12,956
At end of period		128	1,921	10,180	955	1,421	14,605	1	14,606

The accompanying notes are an integral part of these financial statements

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Prudential plc and subsidiaries

Unaudited Condensed Consolidated Statements Of Financial Position

	Note	2017 £m 30 Jun	2016 £m 31 Dec
Assets			
Goodwill	C5(a)	**1,501**	1,628
Deferred acquisition costs and other intangible assets	C5(b)	**10,757**	10,807
Property, plant and equipment		**727**	743
Reinsurers share of insurance contract liabilities		**9,709**	10,051
Deferred tax assets	C7	**4,105**	4,315
Current tax recoverable		**700**	440
Accrued investment income		**2,887**	3,153
Other debtors		**3,417**	3,019
Investment properties		**15,218**	14,646
Investment in joint ventures and associates accounted for using the equity method		**1,293**	1,273
Loans	C3.3	**16,952**	15,173
Equity securities and portfolio holdings in unit trusts		**210,437**	198,552
Debt securities	C3.2	**170,793**	170,458
Derivative assets		**3,789**	3,936
Other investments		**5,566**	5,465
Deposits		**13,353**	12,185
Assets held for sale		**33**	4,589
Cash and cash equivalents		**9,893**	10,065
Total assets	C1	**481,130**	470,498
Equity			
Shareholders equity		**15,449**	14,666
Non-controlling interests		**1**	1
Total equity		**15,450**	14,667
Liabilities			
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)		**398,980**	388,996
Unallocated surplus of with-profits funds		**15,090**	14,317
Core structural borrowings of shareholder-financed operations	C6.1	**6,614**	6,798
Operational borrowings attributable to shareholder-financed operations	C6.2(a)	**2,096**	2,317
Borrowings attributable to with-profits operations	C6.2(b)	**3,336**	1,349
Obligations under funding, securities lending and sale and repurchase agreements		**6,408**	5,031
		8,577	8,687

Net asset value attributable to unit holders of consolidated unit trusts and similar funds			
Deferred tax liabilities	C7	**5,683**	5,370
Current tax liabilities		**743**	649
Accruals, deferred income and other liabilities		**14,524**	13,825
Provisions		**759**	947
Derivative liabilities		**2,870**	3,252
Liabilities held for sale		**-**	4,293
Total liabilities	C1	**465,680**	455,831
Total equity and liabilities		**481,130**	470,498

Included within equity securities and portfolio holdings in unit trusts, debt securities and other investments are £9,182 million of lent securities as at 30 June 2017 (31 December 2016: £8,545 million).

The accompanying notes are an integral part of these financial statements

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Prudential plc and subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

	Note	2017 £m Half year	2016 £m Half year
Cash flows from operating activities			
Profit before tax *(being tax attributable to shareholders and policyholders returns)*note (i)		**2,207**	956
Non-cash movements in operating assets and liabilities reflected in profit before tax:			
Other non-investment and non-cash assets		**(550)**	(2,660)
Investments		**(26,539)**	(21,280)
Policyholder liabilities (including unallocated surplus)		**21,597**	19,548
Other liabilities (including operational borrowings)		**3,390**	3,836
Other itemsnote (ii)		**(15)**	403
Net cash flows from operating activities		**90**	803
Cash flows from investing activities			
Net cash outflows from purchases and disposals of property, plant and equipment		**(56)**	(32)
Net cash inflows (outflows) from corporate transactionsnote (iii)		**813**	(302)
Net cash flows from investing activities		**757**	(334)
Cash flows from financing activities			
Structural borrowings of the Group:			
Shareholder-financed operations:note (iv)	C6.1		
Issue of subordinated debt, net of costs		**-**	681
Interest paid		**(207)**	(160)
With-profits operations:note (v)	C6.2		
Interest paid		**(4)**	(4)
Equity capital:			
Issues of ordinary share capital		**10**	6
Dividends paid		**(786)**	(935)
Net cash flows from financing activities		**(987)**	(412)
Net (decrease) / increase in cash and cash equivalents		**(140)**	57
Cash and cash equivalents at beginning of period		**10,065**	7,782
Effect of exchange rate changes on cash and cash equivalents		**(32)**	691
Cash and cash equivalents at end of period		**9,893**	8,530

Notes

(i) This measure as explained in the footnote to the income statement is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.

(ii) The adjusting items to profit before tax included within other items are adjustments in respect of non-cash items together with operational interest receipts and payments, dividend receipts and tax paid.

(iii)

Net cash flows for corporate transactions are for distribution rights and the acquisition and disposal of businesses (including private equity and other subsidiaries acquired by with-profits funds for investment purposes).

(iv) Structural borrowings of shareholder-financed operations exclude borrowings to support short-term fixed income securities programmes, non-recourse borrowings of investment subsidiaries of shareholder-financed operations and other borrowings of shareholder-financed operations. Cash flows in respect of these borrowings are included within cash flows from operating activities.

The changes in the carrying value of the structural borrowings of shareholder-financed operations during half year 2017 are analysed as follows:

	Balance at 1 Jan 2017	Non-cash movements £m Amortisation of issue costs	Foreign exchange movement	Balance at 30 Jun 2017
Structural borrowings of shareholder-financed operations	**6,798**	**7**	**(191)**	**6,614**

(v) Interest paid on structural borrowings of with-profits operations relate solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds, which contribute to the solvency base of the Scottish Amicable Insurance Fund (SAIF), a ring-fenced sub-fund of the PAC with-profits fund. There is no change in respect of the carrying value of the £100 million structural borrowings of the with-profits operations during half year 2017. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

The accompanying notes are an integral part of these financial statements

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Prudential plc and subsidiaries

Notes to the unaudited condensed consolidated interim financial statements

30 June 2017

A BACKGROUND

A1 Basis of preparation, audit status and exchange rates

These condensed consolidated interim financial statements for the six months ended 30 June 2017 have been prepared in accordance with IAS 34 Interim Financial Reporting as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). The Group s policy for preparing this interim financial information is to use the accounting policies adopted by the Group in its last consolidated financial statements, as updated by any changes in accounting policies it intends to make in its next consolidated financial statements as a result of new or amended IFRS that are applicable or available for early adoption for the next annual financial statements and other policy improvements. EU-endorsed IFRS may differ from IFRSs issued by the IASB if, at any point in time, new or amended IFRS have not been endorsed by the EU. At 30 June 2017, there were no unendorsed standards effective for the period ended 30 June 2017 which impact the condensed consolidated financial statements of the Group, and there were no differences between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to the Group.

The IFRS basis results for the 2017 and 2016 half years are unaudited. The 2016 full year IFRS basis results have been derived from Prudential s 2016 audited consolidated financial statements filed with the Securities and Exchange Commission on Form 20-F. These 2016 consolidated financial statements do not represent Prudential s statutory accounts for the purpose of the UK Companies Act 2006. The auditors have reported on the 2016 statutory accounts which have been delivered to the Registrar of Companies. The auditors report was: (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The exchange rates applied for balances and transactions in currencies other than the presentational currency of the Group, pounds sterling (GBP), were:

	Closing rate at 30 Jun 2017	**Average for the 6 months to 30 Jun 2017**	**Closing rate at 30 Jun 2016**	**Average for the 6 months to 30 Jun 2016**	**Closing rate at 31 Dec 2016**
Local currency: £					
Hong Kong	**10.14**	**9.80**	10.37	11.13	9.58
Indonesia	**17,311.76**	**16,793.63**	17,662.47	19,222.95	16,647.30
Malaysia	**5.58**	**5.53**	5.39	5.87	5.54

Singapore	**1.79**	**1.77**	1.80	1.98	1.79
China	**8.81**	**8.66**	8.88	9.37	8.59
India	**83.96**	**82.77**	90.23	96.30	83.86
Vietnam	**29,526.43**	**28,612.70**	29,815.99	31,996.45	28,136.99
Thailand	**44.13**	**43.72**	46.98	50.81	44.25
US	**1.30**	**1.26**	1.34	1.43	1.24

The accounting policies applied by the Group in determining the IFRS basis results in this report are the same as those previously applied in the Group s consolidated financial statements for the year ended 31 December 2016, as disclosed in the 2016 Form 20-F.

A2 New accounting pronouncements in 2017

The IASB has issued the following new accounting pronouncements to be effective for 1 January 2017:

- Disclosure Initiative (Amendments to IAS 7, Statement of Cash Flows);
- Recognition of deferred tax assets for unrealised losses (Amendments to IAS 12, Income Taxes); and
- Annual Improvements to IFRSs 2014-2016 Cycle.

The pronouncements have yet to be endorsed by the EU and will have no effect on the Group financial statements other than minor changes to disclosures.

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B EARNINGS PERFORMANCE

B1 Analysis of performance by segment

B1.1 Segment results profit before tax

	Note	2017 £m Half year	2016* £m Half year
Asia operations			
Asia insurance operations	B4(a)	**870**	667
Eastspring Investments		**83**	61
Total Asia operations		**953**	728
US operations			
Jackson (US insurance operations)		**1,079**	888
Broker-dealer and asset management		**(6)**	(12)
Total US operations		**1,073**	876
UK operations			
UK insurance operations:	B4(b)		
Long-term business		**480**	473
General insurance commission[note (i)]		**17**	19
Total UK insurance operations		**497**	492
M&G		**248**	225
Prudential Capital		**6**	13
Total UK operations		**751**	730
Total segment profit		**2,777**	2,334
Other income and expenditure			
Investment return and other income		**-**	6
Interest payable on core structural borrowings		**(216)**	(165)
Corporate expenditure[note (ii)]		**(172)**	(156)
Total		**(388)**	(315)
Solvency II implementation costs		**-**	(11)
Restructuring costs[note (iii)]		**(31)**	(7)
Operating profit based on longer-term investment returns before interest received from tax settlement		**2,358**	2,001
Interest received from tax settlement		**-**	43
Operating profit based on longer-term investment returns	B1.3	**2,358**	2,044
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	**(573)**	(1,385)
Amortisation of acquisition accounting adjustments[note (iv)]		**(32)**	(35)
	D1	**61**	-

Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income			
Profit (loss) attaching to the held for sale Korea life business	D1	**-**	40
Profit before tax attributable to shareholders		**1,814**	664
Tax charge attributable to shareholders returns	B5	**(309)**	23
Profit for the period attributable to shareholders		**1,505**	687

Basic earnings per share (in pence)	B6	**2017 Half year**	**2016* Half year**
Based on operating profit based on longer-term investment returns		**70.0p**	61.3p
Based on profit for the period		**58.7p**	26.9p

* The Group completed the sale of its life business in Korea in May 2017.Operating profit based on longer term investment returns for half year 2017 excludes the results attributable to the sold Korea life business, as described in note D1. This

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approach is consistent with the presentation of operating profit for full year 2016 reported in the Group 2016 Annual Report. Comparative operating profit for half year 2016 has been represented in order to show the results of the retained operations on a comparable basis, resulting in a reclassification in half year 2016 of £15 million of operating profit attributable to the Korea life business to non-operating profit.

Notes

(i) General insurance commission represents the commission receivable net of expenses for Prudential-branded general insurance products in connection with the arrangement to transfer the UK general insurance business to Churchill in 2002.
(ii) Corporate expenditure as shown above is for Group Head Office and Asia Regional Head Office.
(iii) Restructuring costs are incurred in the UK and Asia and represent one-off business development expenses.
(iv) Amortisation of acquisition accounting adjustments principally relate to the REALIC business of Jackson.

B1.2 Short-term fluctuations in investment returns on shareholder-backed business

	2017 £m Half year	**2016 £m Half year**
Insurance operations:		
Asia note (i)	**41**	1
US note (ii)	**(754)**	(1,440)
UK note (iii)	**9**	246
Other operations note (iv)	**131**	(192)
Total	**(573)**	(1,385)

* Following its sale in May 2017, the half year 2016 comparative short-term fluctuations in investment returns has been adjusted to exclude the result attributable to the sold Korea life business. This approach is consistent with that applied at full year 2016.

Notes

(i) Asia insurance operations
In Asia, the positive short-term fluctuations of £41 million principally reflect net value movements on shareholders assets and related liabilities following falls in bond yields across the region during the period (half year 2016: positive £1 million).

(ii) US insurance operations
The short-term fluctuations in investment returns for US insurance operations are reported net of related credit for amortisation of deferred acquisition costs, of £231 million as shown in note C5 (half year 2016: credit of £616 million) and comprise amounts in respect of the following items:

	2017 £m Half year	**2016 £m Half year**
Net equity hedge result note (a)	**(782)**	(1,692)
Other than equity-related derivatives note (b)	**12**	335
Debt securities note (c)	**5**	(105)
Equity-type investments: actual less longer-term return	**1**	13
Other items	**10**	9
Total	**(754)**	(1,440)

Notes

(a) Net equity hedge result

The purpose of the inclusion of this item in short-term fluctuations in investment returns is to segregate the amount included in pre-tax profit that relates to the accounting effect of market movements on both the measured value of guarantees in Jackson s variable annuity and fixed index annuity products and on the related derivatives used to manage the exposures inherent in these guarantees. As the Group applies US GAAP for the measured value of the product guarantees this item also includes asymmetric impacts where the measurement bases of the liabilities and associated derivatives used to manage the Jackson annuity business differ as described below.

The result comprises the net effect of:

1 The accounting value movements on the variable and fixed index annuity guarantee liabilities. This includes:

The Guaranteed Minimum Death Benefit (GMDB), and the for life portion of Guaranteed Minimum Withdrawal Benefit (GMWB) guarantees which are measured under the US GAAP basis applied for IFRS in a way that is substantially insensitive to the effect of current period equity market and interest rate changes; and

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The not for life portion of GMWB embedded derivative liabilities which are required to be measured under IAS 39 using a basis under which the projected future growth rate of the account balance is based on current swap rates (rather than expected rates of return) with only a portion of the expected future guarantee fees included. Reserve value movements on these liabilities are sensitive to changes to levels of equity markets, implied volatility and interest rates.

2 Adjustments in respect of fee assessments and claim payments;
3 Fair value movements on free-standing equity derivatives held to manage equity exposures of the variable annuity guarantees and fixed index annuity embedded options; and
4 Related changes to DAC amortisation in accordance with the policy that DAC is amortised in line with emergence of margins.

The net equity hedge result therefore includes significant accounting mismatches and other factors that detract from the presentation of an economic result. These other factors include:

The variable annuity guarantees and fixed index annuity embedded options being only partially fair valued under grandfathered US GAAP;

The interest rate exposure being managed through the other than equity-related derivative programme explained in note (b) below; and

Jackson s management of its economic exposures for a number of other factors that are treated differently in the accounting frameworks such as future fees and assumed volatility levels.

(b) Other than equity-related derivatives

The fluctuations for this item comprise the net effect of:

Fair value movements on free-standing, other than equity-related derivatives;

Accounting effects of the Guaranteed Minimum Income Benefit (GMIB) reinsurance; and

Related amortisation of DAC.

The free-standing, other than equity-related derivatives, are held to manage interest rate exposures and durations within the general account and the variable annuity guarantees and fixed index annuity embedded options described in note (a) above.

The direct GMIB liability is valued using the US GAAP measurement basis applied for IFRS reporting in a way that substantially does not recognise the effects of market movements. Reinsurance arrangements are in place so as to essentially fully insulate Jackson from the GMIB exposure. Notwithstanding that the liability is essentially fully reinsured, as the reinsurance asset is net settled, it is deemed a derivative under IAS 39 which requires fair valuation.

The fluctuations for this item therefore include significant accounting mismatches caused by:

The fair value movements booked in the income statement on the derivative programme being in respect of the management of interest rate exposures of the variable and fixed index annuity business, as well as the fixed annuity business guarantees and durations within the general account;

Fair value movements on Jackson s debt securities of the general account which are recorded in other comprehensive income rather than the income statement; and

The mixed measurement model that applies for the GMIB and its reinsurance.

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(c) Short-term fluctuations related to debt securities

	2017 £m Half year	2016 £m Half year
Short-term fluctuations relating to debt securities		
(Charges) credits in the period:		
Losses on sales of impaired and deteriorating bonds	**(2)**	(87)
Defaults note (v)	-	(6)
Bond write downs	**(1)**	(32)
Recoveries/reversals	**7**	4
Total credits (charges) in the period	**4**	(121)
Less: Risk margin allowance deducted from operating profit based on longer-term investment returns	**46**	42
	50	(79)
Interest-related realised gains:		
Arising in the period	**23**	20
Less: Amortisation of gains and losses arising in current and prior periods to operating profit based on longer-term investment returns	**(72)**	(59)
	(49)	(39)
Related amortisation of deferred acquisition costs	**4**	13
Total short-term fluctuations related to debt securities	**5**	(105)

The debt securities of Jackson are held in the general account of the business. Realised gains and losses are recorded in the income statement with normalised returns included in operating profit and variations from year to year are included in the short-term fluctuations category. The risk margin reserve charge for longer-term credit-related losses included in operating profit based on longer-term investment returns of Jackson for half year 2017 is based on an average annual risk margin reserve of 21 basis points (half year 2016: 21 basis points) on average book values of US$55.8 billion (half year 2016: US$56.4 billion) as shown below:

Moody s rating category (or equivalent under NAIC ratings of mortgage-backed securities)	Half year 2017				Half year 2016			
	Average book value US$m	RMR %	Annual expected loss US$m	£m	Average book value US$m	RMR %	Annual expected loss US$m	£m
A3 or higher	**27,848**	**0.13**	**(35)**	**(28)**	29,172	0.12	(36)	(25)
Baa1, 2 or 3	**26,601**	**0.23**	**(60)**	**(47)**	25,771	0.24	(63)	(44)
Ba1, 2 or 3	**1,052**	**1.03**	**(11)**	**(9)**	1,065	1.08	(11)	(8)
B1, 2 or 3	**311**	**2.75**	**(9)**	**(7)**	319	3.02	(10)	(7)
Below B3	**27**	**3.80**	**(1)**	**(1)**	41	3.81	(2)	(1)
Total	**55,839**	**0.21**	**(116)**	**(92)**	56,368	0.21	(122)	(85)
			22	**17**			22	15

Related amortisation of deferred acquisition costs (see below)				
Risk margin reserve charge to operating profit for longer-term credit-related losses	**(94)**	**(75)**	(100)	(70)

Consistent with the basis of measurement of insurance assets and liabilities for Jackson s IFRS results, the charges and credits to operating profits based on longer-term investment returns are partially offset by related amortisation of deferred acquisition costs.

In addition to the accounting for realised gains and losses described above for Jackson general account debt securities, included within the statement of other comprehensive income is a pre-tax credit of £462 million for net unrealised gains on debt securities classified as available-for-sale net of related amortisation of deferred acquisition costs (half year 2016: credit of £1,683 million for net unrealised gains). Temporary market value movements do not reflect defaults or impairments. Additional details of the movement in the value of the Jackson portfolio are included in note C3.2(b).

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(iii) UK insurance operations

The positive short-term fluctuations in investment returns for UK insurance operations of £9 million (half year 2016: £246 million) include net unrealised movements on fixed income assets supporting the capital of the shareholder-backed annuity business.

(iv) Other

The positive short-term fluctuations in investment returns for other operations of £131 million (half year 2016: negative £(192) million) include unrealised value movements on financial instruments and foreign exchange items.

(v) Default losses

The Group incurred no default losses on its shareholder-backed debt securities portfolio for half year 2017 (half year 2016: £(6) million).

B1.3 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:	**Asset management operations:**
Asia	Eastspring Investments
US (Jackson)	US broker-dealer and asset management
UK	M&G
	Prudential Capital

The Group s operating segments are also its reportable segments for the purposes of internal management 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 measurement basis distinguishes operating profit based on longer-term investment returns from other constituents of the total profit as follows:

- Short-term fluctuations in investment returns on shareholder-backed business;
- Amortisation of acquisition accounting adjustments arising on the purchase of business. This comprises principally the charge for the adjustments arising on the purchase of REALIC in 2012; and
- Profit (loss) attaching to the sold Korea life business including the recycling of the cumulative exchange translation gain on the sold Korea life business from other comprehensive income to the income statement in 2017.

Segment results 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.

The determination of operating profit based on longer-term investment returns for investment and liability movements is as described in the Basis of Performance Measures section of this document.

For Group debt securities at 30 June 2017, the level of unamortised interest-related realised gains and losses related to previously sold bonds and have yet to be amortised to operating profit was a net gain of £876 million (30 June 2016: net gain of £605 million).

For equity-type securities, the longer-term rates of return applied by the non-linked shareholder-financed insurance operations of Asia and the US to determine the amount of investment return included in operating profit are as follows:

For Asia insurance operations, investments in equity securities held for non-linked shareholder-financed operations amounted to £1,535 million as at 30 June 2017 (30 June 2016: £1,035 million). The rates of return applied for 2017 ranged from 4.7 per cent to 17.2 per cent (30 June 2016: 3.2 per cent to 13.0 per cent) with the rates applied varying by business unit.

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For US insurance operations, at 30 June 2017, the equity-type securities for non-separate account operations amounted to £1,256 million (30 June 2016: £1,115 million). The longer-term rates of return for income and capital applied in 2017 and 2016, which reflect the combination of the average risk-free rates over the period and appropriate risk premiums, are as follows:

	2017 Half year	2016 Half year
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	**6.2% to 6.5%**	5.5% to 5.9%
Other equity-type securities such as investments in limited partnerships and private equity funds	**8.2% to 8.5%**	7.5% to 7.9%

B1.4 Additional segmental analysis of revenue

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

	Half year 2017 £m									
	Insurance operations			Asset management						
	Asia	US	UK	M&G	Prudential Capital	US	Eastspring Investments	Total segment	Unallocated to a segment (central operations)	Group total
Gross premium earned	7,697	7,997	6,411	-	-	-	-	22,105	-	22,105
Outward reinsurance	(243)	(168)	(536)	-	-	-	-	(947)	-	(947)
Earned premiums, net of reinsurance	7,454	7,829	5,875	-	-	-	-	21,158	-	21,158
Other income from external customers	56	3	89	576	10	371	103	1,208	14	1,222
Total revenue from external customers	7,510	7,832	5,964	576	10	371	103	22,366	14	22,380
Intra-group revenue	-	-	-	88	20	57	128	293	(293)	-
Interest income	485	1,082	1,754	-	30	-	1	3,352	3	3,355
Other investment return	4,315	7,253	5,605	4	47	1	2	17,227	47	17,274
Total revenue, net of reinsurance	12,310	16,167	13,323	668	107	429	234	43,238	(229)	43,009

Half year 2016 £m

	Insurance operations			Asset management						
	Asia	**US**	**UK**	**M&G**	**Prudential Capital**	**US**	**Eastspring Investments**	**Total segment**	**Unallocated to a segment (central operations)**	**Group total**
Gross premium earned	6,116	6,980	5,242	-	-	-	-	18,338	-	18,338
Outward reinsurance	(401)	(162)	(381)	-	-	-	-	(944)	-	(944)
Earned premiums, net of reinsurance	5,715	6,818	4,861	-	-	-	-	17,394	-	17,394
Other income from external customers	32	1	124	463	2	322	85	1,029	56	1,085
Total revenue from external customers	5,747	6,819	4,985	463	2	322	85	18,423	56	18,479
Intra-group revenue	-	-	-	88	16	47	95	246	(246)	-
Interest income	441	992	2,186	2	36	-	1	3,658	-	3,658
Other investment return	2,241	1,537	9,789	4	(67)	(1)	-	13,503	(99)	13,404
Total revenue, net of reinsurance	8,429	9,348	16,960	557	(13)	368	181	35,830	(289)	35,541

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B2 Profit before tax asset management operations

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

	Prudential M&G	Prudential Capital	US	Eastspring Investments	2017 £m Half year Total	2016 £m Half year Total
Revenue (excluding NPH broker-dealer fees)	**668**	**107**	**124**	**234**	**1,133**	834
NPH broker-dealer fees[note (i)]	**-**	**-**	**305**	**-**	**305**	259
Gross revenue	**668**	**107**	**429**	**234**	**1,438**	1,093
Charges (excluding NPH broker-dealer fees)	**(395)**	**(50)**	**(130)**	**(180)**	**(755)**	(649)
NPH broker-dealer fees[note (i)]	**-**	**-**	**(305)**	**-**	**(305)**	(259)
Gross charges	**(395)**	**(50)**	**(435)**	**(180)**	**(1,060)**	(908)
Share of profits from joint ventures and associates, net of related tax	**8**	**-**	**-**	**29**	**37**	26
Profit before tax	**281**	**57**	**(6)**	**83**	**415**	211
Comprising:						
Operating profit based on longer-term investment returns[note (ii)]	**248**	**6**	**(6)**	**83**	**331**	287
Short-term fluctuations in investment returns	**33**	**51**	**-**	**-**	**84**	(76)
Profit before tax	**281**	**57**	**(6)**	**83**	**415**	211

Notes

(i) NPH broker-dealer fees represent commissions received that are then paid on to the writing brokers on sales of investment products.
To reflect their commercial nature, the amounts 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.

(ii) M&G operating profit based on longer-term investment returns:

	2017 £m Half year	2016 £m Half year
Asset management fee income	**491**	431
Other income	**4**	9
Staff costs	**(166)**	(133)
Other costs	**(95)**	(96)
Underlying profit before performance-related fees	**234**	211
Share of associate s results	**8**	5
Performance-related fees	**6**	9
M&G operating profit based on longer-term investment returns	**248**	225

The revenue for M&G of £501 million (half year 2016: £449 million), comprising the amounts for asset management fee income, other income and performance-related fees shown above, is different to the amount of £668 million shown in the main table of this note. This is because the £501 million (half year 2016: £449 million) is after deducting commissions which would have been included as charges in the main table. The difference in the presentation of commission is aligned with how management reviews the business.

B3 Acquisition costs and other expenditure

	2017 £m Half year	**2016 £m Half year**
Acquisition costs incurred for insurance policies	**(1,920)**	(1,700)
Acquisition costs deferred less amortisation of acquisition costs	**399**	740
Administration costs and other expenditure	**(3,055)**	(2,451)
Movements in amounts attributable to external unit holders of consolidated investment funds	**(754)**	(152)
Total acquisition costs and other expenditure	**(5,330)**	(3,563)

Included in total acquisition costs and other expenditure is depreciation of property, plant and equipment of £(60) million (half year 2016: £(75) million).

B4 Effect of changes and other accounting features on insurance assets and liabilities

The following features are of relevance to the determination of the half year 2017 results:

(a) Asia insurance operations
In half year 2017, the IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £54 million (half year 2016: £42 million) representing a small number of non-recurring items.

(b) UK insurance operations
Annuity business

Allowance for credit risk

For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowances made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest used for discounting projected future annuity payments to policyholders that would have otherwise applied. The credit risk allowance comprises an amount for long-term best estimate defaults and additional provisions for credit risk premium, the cost of downgrades and short-term defaults.

Prudential Retirement Income Limited (PRIL) was the principal company writing the UK s shareholder-backed annuity business. In the second half of 2016, the business of PRIL was transferred into PAC following a Part VII transfer under the Financial Services and Markets Act 2000.

The IFRS credit risk allowance made for the ex-PRIL UK shareholder-backed fixed and linked annuity business equated to 43 basis points at 30 June 2017 (30 June 2016 and 31 December 2016: 43 basis points). The allowance represented 28 per cent of the bond spread over swap rates (30 June 2016: 23 per cent; 31 December 2016: 26 per cent).

The reserves for credit risk allowance at 30 June 2017 for the UK shareholder-backed business (both for ex-PRIL and the legacy PAC shareholder annuity business) were £1.7 billion (30 June 2016: £ 1.8 billion; 31 December 2016: £1.7 billion).

Longevity reinsurance and other management actions

A number of management actions were taken in the first half of 2017 to improve the solvency position of the UK insurance operations and further mitigate market risk, which have generated combined profits of £188 million. Similar actions were also taken in 2016.

Of this amount £31 million related to profit from additional longevity reinsurance transactions covering £0.6 billion of annuity liabilities on an IFRS basis, with the balance of £157 million reflecting the effect of repositioning the fixed income portfolio and other actions.

The contribution to profit from similar longevity reinsurance and other management actions in 2016 was £140 million for the first half of the year (of which £66 million related to longevity reinsurance transactions covering £1.5 billion of

IFRS annuity liabilities).

At 30 June 2017, longevity reinsurance covered £14.8 billion of IFRS annuity liabilities equivalent to 44 per cent of total annuity liabilities (31 December 2016: £14.4 billion, 42 per cent).

Review of past annuity sales

Prudential has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review will examine whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. The review commenced in 2017 and is expected to last a period of three years. A provision of £175 million was established at 31 December 2016 to cover the costs of undertaking

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the review and any potential redress. Other than to cover the small amount of costs incurred in the period, no change has been made to this provision as at 30 June 2017. The ultimate amount that will be expended by the Group on the review remains uncertain. Although the Group s professional indemnity insurance may mitigate the overall financial impact of this review, with potential insurance recoveries of up to £175 million, no such recovery has been factored in the provision, in accordance with the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets .

B5 Tax charge

(a) Total tax charge by nature of expense

The total tax charge in the income statement is as follows:

	2017 £m			2016 £m
	Current	Deferred		Half year
Tax charge	**tax**	**tax**	**Half year Total**	**Total**
UK tax	**(240)**	**(66)**	**(306)**	(229)
Overseas tax	**(187)**	**(209)**	**(396)**	(40)
Total tax charge	**(427)**	**(275)**	**(702)**	(269)

The current tax charge of £427 million includes £37 million (half year 2016: £27 million) in respect of the tax charge for the Hong Kong operation. The Hong Kong current tax charge is calculated as 16.5 per cent for all periods on either: (i) 5 per cent of the net insurance premium; or (ii) the estimated assessable profits, depending on the nature of the business written.

The total tax charge comprises tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders as shown below:

	2017 £m			2016 £m
	Current	Deferred		Half year
Tax charge	**tax**	**tax**	**Half year Total**	**Total**
Tax (charge) to policyholders returns	**(247)**	**(146)**	**(393)**	(292)
Tax (charge) credit attributable to shareholders	**(180)**	**(129)**	**(309)**	23
Total tax (charge)	**(427)**	**(275)**	**(702)**	(269)

The principal reason for the increase in the tax charge attributable to policyholders returns compared to half year 2016 is an increase on investment return in the with-profits fund in the UK insurance operations. The principal reason for the increase in the tax charge attributable to shareholders returns compared to half year 2016 is a reduction in the deferred tax credit on derivative fair value movements in the US insurance operations.

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(b) Reconciliation of effective tax rate

In the reconciliation below, the expected tax rates reflect the corporate income tax rates that are expected to apply to the taxable profit of the relevant business. Where there are profits of more than one jurisdiction the expected tax rates reflect the corporation tax rates weighted by reference to the amount of profit contributing to the aggregate business result. In the column Attributable to policyholders , the 100 per cent expected tax rate is the result of accounting for policyholder income after the deduction of expenses and movement on unallocated surpluses and on an after tax basis, the effect of which leaves the profit equal to the tax charge.

	Half year 2017 £m						
	Asia insurance operations	US insurance operations	UK insurance operations	Other operations	Attributable to shareholders	Attributable to policyholders	Total
Operating profit (loss) based on longer-term investment returns	**870**	**1,079**	**497**	**(88)**	**2,358**	**n/a**	**n/a**
Non-operating profit (loss)	**98**	**(782)**	**9**	**131**	**(544)**	**n/a**	**n/a**
Profit before tax	**968**	**297**	**506**	**43**	**1,814**	**393**	**2,207**
Expected tax rate	**20%**	**35%**	**19%**	**19%**	**22%**	**100%**	**36%**
Tax at the expected rate	**194**	**104**	**96**	**8**	**402**	**393**	**795**
Effects of recurring tax reconciliation items:							
Income not taxable or taxable at concessionary rates	**(18)**	**(10)**		**(3)**	**(31)**		**(31)**
Deductions not allowable for tax purposes	**8**		**5**	**5**	**18**		**18**
Items related to taxation of life insurance businesses	**(43)**	**(85)**	**(2)**		**(130)**		**(130)**
Deferred tax adjustments	**4**		**(1)**		**3**		**3**
Effect of results of joint ventures and associates	**(11)**			**(9)**	**(20)**		**(20)**
Irrecoverable withholding taxes				**29**	**29**		**29**
Other		**4**	**2**	**4**	**10**		**10**
Total	**(60)**	**(91)**	**4**	**26**	**(121)**		**(121)**
Effects of non-recurring tax reconciliation items:							
Adjustments to tax charge in relation to prior years		**10**	**(5)**	**(1)**	**4**		**4**
Movements in provisions for open tax matters	**7**	**25**			**32**		**32**
Cumulative exchange gains on the sold Korea life business recycled from other comprehensive income	**(8)**				**(8)**		**(8)**

Total	**(1)**	**35**	**(5)**	**(1)**	**28**		**28**
Total actual tax charge	**133**	**48**	**95**	**33**	**309**	**393**	**702**
Analysed into:							
Tax on operating profit based on longer-term investment returns	**141**	**322**	**92**	**8**	**563**	**n/a**	**n/a**
Tax on non-operating profit	**(8)**	**(274)**	**3**	**25**	**(254)**	**n/a**	**n/a**
Actual tax rate:							
Operating profit based on longer-term investment returns							
Including non-recurring tax reconciling items	**16%**	**30%**	**19%**	**(9)%**	**24%**	**n/a**	**n/a**
Excluding non-recurring tax reconciling items	**15%**	**27%**	**20%**	**(10)%**	**22%**	**n/a**	**n/a**
Total profit	**14%**	**16%**	**19%**	**77%**	**17%**	**100%**	**32%**

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The more significant reconciling items are explained below:

Asia insurance operations

The £18 million reconciling item *income not taxable or taxable at concessionary rates* primarily reflects income not subject to the full rate of corporate tax in Malaysia, Singapore and Taiwan.

The £43 million reconciling item *items related to taxation of life insurance businesses* reflects where the basis of tax is not the accounting profits, primarily in:

- Hong Kong where the taxable profit is based on the net insurance premiums; and
- Indonesia and Philippines where investment income is subject to withholding tax at source and no further corporation tax.

The £11 million reconciling item *effect of results of the joint ventures and associates* arises from the accounting requirement for inclusion in the profit before tax of Prudential s share of the profits after tax from the joint ventures and associates, with no equivalent item included in Prudential s tax charge.

The £8 million reconciling item *cumulative exchange gain on the sold Korea life business recycled from other comprehensive income* reflects the non-taxable exchange gain arising on the Korea life business previously taken through other comprehensive income on a period-by-period basis recycled through the income statement following the sale of the business.

US insurance operations

The £85 million reconciling item *items related to taxation of life insurance businesses* reflects the impact of the dividend received deduction on the taxation of profits from the variable annuity business.

UK insurance operations

There are no significant reconciling items or significant movements from half year 2016.

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Other operations

The £29 million reconciling item *irrecoverable withholding taxes* relates to withholding tax suffered on distributions from group companies which cannot be recovered against other taxes paid. Other operations comprise the Group s asset management businesses and central operations.

	Half year 2016* £m						
	Asia insurance operations	**US insurance operations**	**UK insurance operations**	**Other operations**	**Attributable to shareholders**	**Attributable to policyholders**	**Total**
Operating profit (loss) based on longer-term investment returns*	667	888	492	(3)	2,044	n/a	n/a
Non-operating profit (loss)	37	(1,471)	246	(192)	(1,380)	n/a	n/a
Profit (loss) before tax	704	(583)	738	(195)	664	292	956
Expected tax rate	21%	35%	20%	20%	8%	100%	36%
Tax at the expected rate	148	(204)	148	(39)	53	292	345
Effects of recurring tax reconciliation items:							
Income not taxable or taxable at concessionary rates	(14)	(5)	(16)	(3)	(38)		(38)
Deductions not allowable for tax purposes	8	2	6	2	18		18
Items related to taxation of life insurance businesses	(10)	(60)	(1)	-	(71)		(71)
Deferred tax adjustments	(1)	-	3	(3)	(1)		(1)
Effect of results of joint ventures and associates	(10)	-	-	(7)	(17)		(17)
Irrecoverable withholding taxes	-	-	-	20	20		20
Other	3	-	(2)	16	17		17
Total	(24)	(63)	(10)	25	(72)		(72)
Effects of non-recurring tax reconciliation items:							
Adjustments to tax charge in relation to prior years	1	(3)	-	(2)	(4)		(4)
Total	1	(3)	-	(2)	(4)		(4)
Total actual tax charge (credit)	125	(270)	138	(16)	(23)	292	269
Analysed into:							
Tax on operating profit based on longer-term investment returns	116	245	101	13	475	n/a	n/a
Tax on non-operating profit	9	(515)	37	(29)	(498)	n/a	n/a

Actual tax rate:							
Operating profit based on longer-term investment returns							
Including non-recurring tax reconciling items	17%	28%	21%	(433)%	23%	n/a	n/a
Excluding non-recurring tax reconciling items	17%	28%	21%	(500)%	23%	n/a	n/a
Total profit	18%	46%	19%	8%	(3)%	100%	28%

* Following its sale in May 2017, the half year 2016 comparative operating result has been adjusted to exclude the result attributable to the sold Korea life business. This approach is consistent with that applied at full year 2016.

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B6 Earnings per share

		Half year 2017				
	Note	Before tax note B1.1 £m	Tax note B5 £m	Net of tax £m	Basic earnings per share pence	Diluted earnings per share pence
Based on operating profit based on longer-term investment returns		**2,358**	**(563)**	**1,795**	**70.0p**	**69.9p**
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	**(573)**	**248**	**(325)**	**(12.7)p**	**(12.7)p**
Amortisation of acquisition accounting adjustments		**(32)**	**6**	**(26)**	**(1.0)p**	**(1.0)p**
Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income		**61**	**-**	**61**	**2.4p**	**2.4p**
Based on profit for the period		**1,814**	**(309)**	**1,505**	**58.7p**	**58.6p**

		Half year 2016*				
	Note	Before tax note B1.1 £m	Tax note B5 £m	Net of tax £m	Basic earnings per share pence	Diluted earnings per share pence
Based on operating profit based on longer-term investment returns		2,044	(475)	1,569	61.3p	61.2p
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	(1,385)	496	(889)	(34.7)p	(34.7)p
Amortisation of acquisition accounting adjustments		(35)	11	(24)	(0.9)p	(0.9)p
Profit attaching to held for sale Korea life business	D1	40	(9)	31	1.2p	1.2p
Based on profit for the period		664	23	687	26.9p	26.8p

* Following its sale in May 2017, the half year 2016 comparative operating result has been adjusted to exclude the result attributable to the sold Korea life business. This approach is consistent with that applied at full year 2016.

Earnings per share are calculated based on earnings attributable to ordinary shareholders, after related tax and non-controlling interests.

The weighted average number of shares for calculating earnings per share, which excludes those held in employee share trusts and consolidated unit trusts and OEICs, is set out as below:

Weighted average number of shares for calculation of:	Half year 2017 (millions)	Half year 2016 (millions)
Basic earnings per share	**2,565**	2,558
Diluted earnings per share	**2,567**	2,559

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B7 Dividends

	Half year 2017		Half year 2016	
	Pence per share	**£m**	**Pence per share**	**£m**
Dividends relating to reporting period:				
First interim ordinary dividend	**14.50p**	**375**	12.93p	333
Dividends paid in reporting period:				
Second interim ordinary dividend for prior year	**30.57p**	**786**	26.47p	679
Special dividend for prior year	**-**	**-**	10.00p	256
Total	**30.57p**	**786**	36.47p	935

Dividend per share

The second interim dividend of 30.57 pence per ordinary share for the year ended 31 December 2016 was paid to eligible shareholders on 19 May 2017.

The 2017 first interim dividend of 14.50 pence per ordinary share will be paid on 28 September 2017 in sterling to shareholders on the principal (UK) register and the Irish branch register at 6.00pm BST on 25 August 2017 (Record Date), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm Hong Kong time on the Record Date (HK Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 9 August 2017. Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 5 October 2017. The exchange rate at which the dividend payable to the US Shareholders will be translated into US dollars will be determined by the depositary agent. The first interim dividend will be paid on or about 5 October 2017 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte.) Limited (CDP) at 5.00pm Singapore time on the Record Date (SG Shareholders). The exchange rate at which the dividend payable to the SG Shareholders will be translated from Hong Kong dollars into Singapore dollars, will be determined by CDP.

Shareholders on the principal (UK) register and Irish branch register will be able to participate in a Dividend Reinvestment Plan.

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C BALANCE SHEET NOTES

C1 Analysis of Group statement of financial position by segment

To explain the assets, liabilities and capital of the Group s businesses more comprehensively, it is appropriate to provide analyses of the Group s statement of financial position by operating segment and type of business.

	Insurance operations			30 Jun 2017 £m Asset management				Unallocated			31 Dec 2016 £m
					Prudential	Eastspring		to a segment (central	Elimination of intra-group debtors and	Group	Group
By operating segment	Asia	US	UK	M&G	Capital	Investments	US	operations)	creditors	Total	Total
	C2.1	C2.2	C2.3								
Assets											
Goodwill C5(a)	**245**	**-**	**26**	**1,153**	**-**	**16**	**61**	**-**	**-**	**1,501**	1,628
Deferred acquisition costs and other intangible assets C5(b)	**2,340**	**8,187**	**168**	**6**	**-**	**5**	**4**	**47**	**-**	**10,757**	10,807
Property, plant and equipment	**119**	**224**	**344**	**4**	**-**	**8**	**3**	**25**	**-**	**727**	743
Reinsurers share of insurance contract liabilities	**1,680**	**6,740**	**2,560**	**-**	**-**	**-**	**-**	**-**	**(1,271)**	**9,709**	10,051
Deferred tax assets C7	**85**	**3,678**	**127**	**20**	**7**	**130**	**8**	**50**	**-**	**4,105**	4,315
Current tax recoverable	**30**	**348**	**311**	**-**	**5**	**6**	**-**	**70**	**(70)**	**700**	440
Accrued investment income note (i)	**565**	**493**	**1,650**	**7**	**23**	**76**	**32**	**41**	**-**	**2,887**	3,153
Other debtors note (ii)	**2,598**	**260**	**2,796**	**1,000**	**758**	**73**	**62**	**5,418**	**(9,548)**	**3,417**	3,019
Investment properties	**5**	**6**	**15,207**	**-**	**-**	**-**	**-**	**-**	**-**	**15,218**	14,646
	714	**-**	**405**	**39**	**-**	**-**	**135**	**-**	**-**	**1,293**	1,273

Investment in joint ventures and associates accounted for using the equity method											
Loans[C3.3]	**1,307**	**9,497**	**5,784**	**-**	**364**	**-**	**-**	**-**	**-**	**16,952**	15,173
Equity securities and portfolio holdings in unit trusts	**26,753**	**125,059**	**58,398**	**111**	**-**	**-**	**19**	**97**	**-**	**210,437**	198,552
Debt securities[C3.2]	**39,061**	**38,029**	**91,302**	**-**	**2,381**	**-**	**-**	**20**	**-**	**170,793**	170,458
Derivative assets	**102**	**906**	**2,676**	**-**	**101**	**-**	**-**	**4**	**-**	**3,789**	3,936
Other investments	**-**	**932**	**4,614**	**16**	**-**	**4**	**-**	**-**	**-**	**5,566**	5,465
Deposits	**1,243**	**-**	**11,843**	**-**	**-**	**18**	**44**	**205**	**-**	**13,353**	12,185
Assets held for sale	**-**	**-**	**33**	**-**	**-**	**-**	**-**	**-**	**-**	**33**	4,589
Cash and cash equivalents note (ii)	**1,786**	**1,194**	**4,565**	**350**	**1,451**	**276**	**156**	**115**	**-**	**9,893**	10,065
Total assets	**78,633**	**195,553**	**202,809**	**2,706**	**5,090**	**612**	**524**	**6,092**	**(10,889)**	**481,130**	470,498

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	Insurance operations			30 Jun 2017 £m Asset management				Unallocated to a segment (central operations)	Elimination of intra-group debtors and creditors	Group Total	31 I 2016 Gr T
	Asia	US	UK	M&G	Prudential Capital	US	Eastspring Investments				
perating ent	C2.1	C2.2	C2.3								
l equity	**5,181**	**5,011**	**6,227**	**1,868**	**61**	**202**	**382**	**(3,482)**	**-**	**15,450**	14
ilities											
ract liabilities uding amounts in ct of contracts ified as tment contracts r IFRS 4)[C4.1]	**59,619**	**177,779**	**162,853**	**-**	**-**	**-**	**-**	**-**	**(1,271)**	**398,980**	388
located surplus th-profits s[C4.1]	**3,003**	**-**	**12,087**	**-**	**-**	**-**	**-**	**-**	**-**	**15,090**	14
structural owings of holder-financed tions[C6.1]	**-**	**192**	**-**	**-**	**275**	**-**	**-**	**6,147**	**-**	**6,614**	6
ational owings utable to holder-financed tions[note (iv),])	**20**	**453**	**147**	**52**	**-**	**-**	**-**	**1,424**	**-**	**2,096**	2
owings utable to profits tions[C6.2(b)]	**20**	**-**	**3,316**	**-**	**-**	**-**	**-**	**-**	**-**	**3,336**	1
gations under ng, securities ng and sale and rchase ements	**-**	**4,518**	**1,890**	**-**	**-**	**-**	**-**	**-**	**-**	**6,408**	5
sset value utable to unit rs of olidated unit s and similar	**3,541**	**-**	**5,036**	**-**	**-**	**-**	**-**	**-**	**-**	**8,577**	8

s											
rred tax itiesC7	**1,021**	**2,981**	**1,646**	**21**	**-**	**2**	**1**	**11**	**-**	**5,683**	5
ent tax liabilities	**162**	**58**	**451**	**37**	**20**	**2**	**13**	**70**	**(70)**	**743**	
uals, deferred me and other ities	**5,804**	**4,517**	**7,035**	**547**	**4,208**	**406**	**75**	**1,480**	**(9,548)**	**14,524**	13
sions	**138**	**1**	**350**	**181**	**-**	**-**	**53**	**36**	**-**	**759**	
vative liabilities	**124**	**43**	**1,771**	**-**	**526**	**-**	**-**	**406**	**-**	**2,870**	3
lities held for	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	4
l liabilities	**73,452**	**190,542**	**196,582**	**838**	**5,029**	**410**	**142**	**9,574**	**(10,889)**	**465,680**	455
l equity and lities	**78,633**	**195,553**	**202,809**	**2,706**	**5,090**	**612**	**524**	**6,092**	**(10,889)**	**481,130**	470

Notes

(i) £409 million (31 December 2016: £413 million) of the property, plant and equipment of £727 million (31 December 2016: £743 million) was held by the Group s with-profits operations, primarily by the consolidated subsidiaries for venture funds and other investment purposes of the PAC with-profits fund. The Group made additions to property, plant and equipment of £120 million during the period (31 December 2016: £348 million).

(ii) Reinsurers share of contract liabilities relate primarily to the reinsurance ceded in respect of the acquired REALIC business by the Group s US insurance operations.

(iii) Within other debtors are premiums receivable of £432 million (31 December 2016: £498 million) of which 77 per cent are due within one year. The remaining 23 per cent is due after one year.

(iv) Within Accruals, deferred income and other liabilities of £14,524 million (31 December 2016: £13,825 million) is an amount of £8,575 million (31 December 2016: £9,873 million) that is due within one year.

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C2 Analysis of segment statement of financial position by business type

To show the statement of financial position by reference to the differing degrees of policyholder and shareholder economic interest of the different types of business, the analysis below is structured to show the assets and liabilities of each segment by business type.

C2.1 Asia insurance operations

			2017 £m			2016 £m
			Unit-linked			
		With-profits	assets and	Other	30 Jun	31 Dec
	Note	business	liabilities	business	Total	Total
Assets						
Goodwill		**-**	**-**	**245**	**245**	245
Deferred acquisition costs and other intangible assets		**31**	**-**	**2,309**	**2,340**	2,316
Property, plant and equipment		**82**	**-**	**37**	**119**	121
Reinsurers share of insurance contract liabilities		**50**	**-**	**1,630**	**1,680**	1,539
Deferred tax assets		**-**	**-**	**85**	**85**	98
Current tax recoverable		**-**	**-**	**30**	**30**	29
Accrued investment income		**253**	**60**	**252**	**565**	521
Other debtors		**1,847**	**189**	**562**	**2,598**	2,633
Investment properties		**-**	**-**	**5**	**5**	5
Investment in joint ventures and associates accounted for using the equity method		**-**	**-**	**714**	**714**	688
Loans	C3.3	**702**	**-**	**605**	**1,307**	1,303
Equity securities and portfolio holdings in unit trusts		**12,821**	**12,397**	**1,535**	**26,753**	23,581
Debt securities	C3.2	**23,398**	**3,442**	**12,221**	**39,061**	36,546
Derivative assets		**58**	**3**	**41**	**102**	47
Deposits		**307**	**393**	**543**	**1,243**	1,379
Assets held for sale		**-**	**-**	**-**	**-**	3,863
Cash and cash equivalents		**733**	**234**	**819**	**1,786**	1,995
Total assets		**40,282**	**16,718**	**21,633**	**78,633**	76,909
Total equity		**-**	**-**	**5,181**	**5,181**	4,993
Liabilities						
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(b)	**31,549**	**15,326**	**12,744**	**59,619**	55,018
Unallocated surplus of with-profits funds	C4.1(b)	**3,003**	**-**	**-**	**3,003**	2,667
Operational borrowings attributable to shareholder-financed operations		**-**	**13**	**7**	**20**	19
		20	**-**	**-**	**20**	4

Borrowings attributable to with-profits operations					
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	**2,114**	**1,201**	**226**	**3,541**	3,093
Deferred tax liabilities	**705**	**38**	**278**	**1,021**	935
Current tax liabilities	**64**	**-**	**98**	**162**	113
Accruals, deferred income and other liabilities	**2,667**	**138**	**2,999**	**5,804**	5,887
Provisions	**48**	**-**	**90**	**138**	157
Derivative liabilities	**112**	**2**	**10**	**124**	265
Liabilities held for sale	**-**	**-**	**-**	**-**	3,758
Total liabilities	**40,282**	**16,718**	**16,452**	**73,452**	71,916
Total equity and liabilities	**40,282**	**16,718**	**21,633**	**78,633**	76,909

Note

The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore operations. Assets and liabilities of other participating businesses are included in the column for Other business .

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C2.2 US insurance operations

		2017 £m			2016 £m
		Variable annuity separate account assets and liabilities	Fixed annuity, GIC and other business	30 Jun Total	31 Dec Total
	Note				
Assets					
Deferred acquisition costs and other intangible assets		**-**	**8,187**	**8,187**	8,323
Property, plant and equipment		**-**	**224**	**224**	237
Reinsurers share of insurance contract liabilities		**-**	**6,740**	**6,740**	7,224
Deferred tax assets		**-**	**3,678**	**3,678**	3,861
Current tax recoverable		**-**	**348**	**348**	95
Accrued investment income		**-**	**493**	**493**	549
Other debtors		**-**	**260**	**260**	295
Investment properties		**-**	**6**	**6**	6
Loans	C3.3	**-**	**9,497**	**9,497**	9,735
Equity securities and portfolio holdings in unit trusts		**124,735**	**324**	**125,059**	120,747
Debt securities	C3.2	**-**	**38,029**	**38,029**	40,745
Derivative assets		**-**	**906**	**906**	834
Other investments		**-**	**932**	**932**	987
Cash and cash equivalents		**-**	**1,194**	**1,194**	1,054
Total assets		**124,735**	**70,818**	**195,553**	194,692
Total equity		**-**	**5,011**	**5,011**	5,204
Liabilities					
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(c)	**124,735**	**53,044**	**177,779**	177,626
Core structural borrowings of shareholder-financed operations		**-**	**192**	**192**	202
Operational borrowings attributable to shareholder-financed operations		**-**	**453**	**453**	480
Obligations under funding, securities lending and sale and repurchase agreements		**-**	**4,518**	**4,518**	3,534
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		**-**	**-**	**-**	-

Deferred tax liabilities	**-**	**2,981**	**2,981**	2,831
Current tax liabilities	**-**	**58**	**58**	-
Accruals, deferred income and other liabilities	**-**	**4,517**	**4,517**	4,749
Provisions	**-**	**1**	**1**	2
Derivative liabilities	**-**	**43**	**43**	64
Total liabilities	**124,735**	**65,807**	**190,542**	189,488
Total equity and liabilities	**124,735**	**70,818**	**195,553**	194,692

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C2.3 UK insurance operations

By operating segment	Note	2017 £m With-profits sub-funds note (i)	2017 £m Other funds and subsidiaries Unit-linked assets and liabilities	2017 £m Other funds and subsidiaries Annuity and other long-term business	2017 £m Other funds and subsidiaries Total	30 Jun Total	2016 £m 31 Dec Total
Assets							
Goodwill		**26**	**-**	**-**	**-**	**26**	153
Deferred acquisition costs and other intangible assets		**82**	**-**	**86**	**86**	**168**	107
Property, plant and equipment		**327**	**-**	**17**	**17**	**344**	343
Reinsurers share of insurance contract liabilities		**1,308**	**135**	**1,117**	**1,252**	**2,560**	2,590
Deferred tax assets		**73**	**-**	**54**	**54**	**127**	146
Current tax recoverable		**179**	**-**	**132**	**132**	**311**	283
Accrued investment income		**1,040**	**93**	**517**	**610**	**1,650**	1,915
Other debtors		**1,895**	**224**	**677**	**901**	**2,796**	2,447
Investment properties		**12,962**	**650**	**1,595**	**2,245**	**15,207**	14,635
Investment in joint ventures and associates accounted for using the equity method		**405**	**-**	**-**	**-**	**405**	409
Loans	C3.3	**4,036**	**-**	**1,748**	**1,748**	**5,784**	3,572
Equity securities and portfolio holdings in unit trusts		**43,023**	**15,339**	**36**	**15,375**	**58,398**	54,037
Debt securities	C3.2	**49,165**	**6,743**	**35,394**	**42,137**	**91,302**	90,796
Derivative assets		**2,183**	**3**	**490**	**493**	**2,676**	2,927
Other investments		**4,608**	**5**	**1**	**6**	**4,614**	4,449
Deposits		**9,542**	**968**	**1,333**	**2,301**	**11,843**	10,705
Assets held for sale note (ii)		**33**	**-**	**-**	**-**	**33**	726
Cash and cash equivalents		**3,230**	**762**	**573**	**1,335**	**4,565**	4,703
Total assets		**134,117**	**24,922**	**43,770**	**68,692**	**202,809**	194,943
Total equity		**-**	**-**	**6,227**	**6,227**	**6,227**	5,999
Liabilities							

Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(d)	**106,362**	**22,917**	**33,574**	**56,491**	**162,853**	157,654
Unallocated surplus of with-profits funds	C4.1(d)	**12,087**	**-**	**-**	**-**	**12,087**	11,650
Operational borrowings attributable to shareholder-financed operations		**-**	**4**	**143**	**147**	**147**	167
Borrowings attributable to with-profits operations		**3,316**	**-**	**-**	**-**	**3,316**	1,345
Obligations under funding, securities lending and sale and repurchase agreements		**1,216**	**-**	**674**	**674**	**1,890**	1,497
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		**3,152**	**1,856**	**28**	**1,884**	**5,036**	5,594
Deferred tax liabilities		**1,354**	**-**	**292**	**292**	**1,646**	1,577
Current tax liabilities		**246**	**68**	**137**	**205**	**451**	447
Accruals, deferred income and other liabilities		**5,604**	**76**	**1,355**	**1,431**	**7,035**	6,176
Provisions		**62**	**-**	**288**	**288**	**350**	442
Derivative liabilities		**718**	**1**	**1,052**	**1,053**	**1,771**	1,860
Liabilities held for sale[note (ii)]		**-**	**-**	**-**	**-**	**-**	535
Total liabilities		**134,117**	**24,922**	**37,543**	**62,465**	**196,582**	188,944
Total equity and liabilities		**134,117**	**24,922**	**43,770**	**68,692**	**202,809**	194,943

Notes

(i) Includes the Scottish Amicable Insurance Fund which, at 30 June 2017, has total assets and liabilities of £5,943 million (31 December 2016: £6,101 million). The PAC with-profits sub-fund (WPSF) mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The PAC with-profits fund includes £10.9 billion (31 December 2016: £11.2 billion) of non-profits annuities liabilities.

(ii) The assets and liabilities held for sale for the UK insurance operations comprise the investment properties and consolidated private equity investments of the PAC with-profits fund, for which the sales had been agreed but not yet completed at the period end.

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C3 Assets and liabilities classification and measurement

C3.1 Group assets and liabilities measurement

(a) Determination of fair value

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments, or by using quotations from independent third parties, such as brokers and pricing services or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm s length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third parties or valued internally using standard market practices.

Other than the loans which have been designated at fair value through profit or loss, the loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The discount rate used is updated for the market rate of interest where applicable.

The fair value of investment properties is based on market values as assessed by professionally qualified external valuers or by the Group s qualified surveyors.

The fair value of financial liabilities (other than derivative financial instruments) and borrowings that are carried at fair value through profit or loss is determined using discounted cash flows of the amounts expected to be paid.

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(b) Fair value hierarchy of financial instruments measured at fair value on recurring basis
Assets and liabilities carried at fair value on the statement of financial position

The table below shows the financial instruments carried at fair value analysed by level of the IFRS 13 Fair Value Measurement defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

Financial instruments at fair value

	30 Jun 2017 £m			
	Level 1	Level 2	Level 3	
Analysis of financial investments, net of derivative liabilities by business type	**Quoted prices (unadjusted) in active markets**	**Valuation based on significant observable market inputs**	**Valuation based on significant unobservable market inputs**	**Total**
With-profits				
Loans	-	-	1,906	1,906
Equity securities and portfolio holdings in unit trusts	51,136	4,282	426	55,844
Debt securities	28,122	44,145	296	72,563
Other investments (including derivative assets)	73	3,310	3,464	6,847
Derivative liabilities	(79)	(752)	-	(831)
Total financial investments, net of derivative liabilities	79,252	50,985	6,092	136,329
Percentage of total	58%	38%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	152,050	399	23	152,472
Debt securities	5,243	4,943	-	10,186
Other investments (including derivative assets)	4	3	4	11
Derivative liabilities	(2)	-	-	(2)
Total financial investments, net of derivative liabilities	157,295	5,345	27	162,667
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	-	309	2,594	2,903
Equity securities and portfolio holdings in unit trusts	2,104	7	10	2,121
Debt securities	21,525	66,233	286	88,044
Other investments (including derivative assets)	(25)	1,526	996	2,497
Derivative liabilities	(1)	(1,576)	(460)	(2,037)
Total financial investments, net of derivative liabilities	23,603	66,499	3,426	93,528
Percentage of total	25%	71%	4%	100%

Group total analysis, including other financial liabilities held at fair value

Group total				
Loans	**-**	**309**	**4,500**	**4,809**
Equity securities and portfolio holdings in unit trusts	**205,290**	**4,688**	**459**	**210,437**
Debt securities	**54,890**	**115,321**	**582**	**170,793**
Other investments (including derivative assets)	**52**	**4,839**	**4,464**	**9,355**
Derivative liabilities	**(82)**	**(2,328)**	**(460)**	**(2,870)**
Total financial investments, net of derivative liabilities	**260,150**	**122,829**	**9,545**	**392,524**
Investment contract liabilities without discretionary participation features held at fair value	**-**	**(17,166)**	**-**	**(17,166)**
Borrowings attributable to with-profits operations	**-**	**-**	**(1,816)**	**(1,816)**
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	**(5,719)**	**(2,421)**	**(437)**	**(8,577)**
Other financial liabilities held at fair value	**-**	**(394)**	**(2,766)**	**(3,160)**
Total financial instruments at fair value	**254,431**	**102,848**	**4,526**	**361,805**
Percentage of total	**70%**	**29%**	**1%**	**100%**

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Analysis of financial investments, net of derivative liabilities by business type	31 Dec 2016 £m Level 1 Quoted prices (unadjusted) in active markets	Level 2 Valuation based on significant observable market inputs	Level 3 Valuation based on significant unobservable market inputs	Total
With-profits				
Loans	-	-	27	27
Equity securities and portfolio holdings in unit trusts	45,181	3,669	690	49,540
Debt securities	26,227	43,880	690	70,797
Other investments (including derivative assets)	58	3,357	3,443	6,858
Derivative liabilities	(51)	(1,025)	-	(1,076)
Total financial investments, net of derivative liabilities	71,415	49,881	4,850	126,146
Percentage of total	56%	40%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	146,637	374	22	147,033
Debt securities	5,136	4,462	-	9,598
Other investments (including derivative assets)	6	8	5	19
Derivative liabilities	(4)	(24)	-	(28)
Total financial investments, net of derivative liabilities	151,775	4,820	27	156,622
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	-	276	2,672	2,948
Equity securities and portfolio holdings in unit trusts	1,966	3	10	1,979
Debt securities	21,896	67,915	252	90,063
Other investments (including derivative assets)	-	1,492	1,032	2,524
Derivative liabilities	(9)	(1,623)	(516)	(2,148)
Total financial investments, net of derivative liabilities	23,853	68,063	3,450	95,366
Percentage of total	25%	71%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	-	276	2,699	2,975
Equity securities and portfolio holdings in	193,784	4,046	722	198,552

unit trusts				
Debt securities	53,259	116,257	942	170,458
Other investments (including derivative assets)	64	4,857	4,480	9,401
Derivative liabilities	(64)	(2,672)	(516)	(3,252)
Total financial investments, net of derivative liabilities	247,043	122,764	8,327	378,134
Investment contract liabilities without discretionary participation features held at fair value	-	(16,425)	-	(16,425)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(4,217)	(3,587)	(883)	(8,687)
Other financial liabilities held at fair value	-	(385)	(2,851)	(3,236)
Total financial instruments at fair value	242,826	102,367	4,593	349,786
Percentage of total	70%	29%	1%	100%

All assets and liabilities held at fair value are classified as fair value through profit or loss, except for £37,936 million (31 December 2016: £40,645 million) of debt securities classified as available-for-sale.

The Korea life business was classified as held for sale in the second half of 2016, with the sale completed in May 2017. Accordingly, the financial instruments shown above only included the assets and liabilities of Korea life business as at 30 June 2016 (prior to its classification as held for sale). The assets and liabilities held for sale on the consolidated statement of financial position at 31 December 2016 in respect of Korea life business included a net financial instruments balance of £3,200 million, primarily for equity securities and debt securities. Of this amount, £2,763 million was classified as level 1 and £437 million as level 2.

(c) Valuation approach for level 2 fair valued financial instruments

A significant proportion of the Group s level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades. For further

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detail on the valuation approach for level 2 fair valued financial instruments please refer to note C3.1 of the Group s consolidated financial statements for the year ended 31 December 2016.

Of the total level 2 debt securities of £115,321 million at 30 June 2017 (31 December 2016: £116,257 million), £13,596 million are valued internally (31 December 2016: £12,708 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

(d) Fair value measurements for level 3 fair valued financial instruments

Reconciliation of movements in level 3 financial instruments measured at fair value

The following table reconciles the value of level 3 fair valued financial instruments at 1 January 2017 to that presented at 30 June 2017.

Total investment return recorded in the income statement represents interest and dividend income, realised gains and losses, unrealised gains and losses on the assets classified at fair value through profit and loss and foreign exchange movements on an individual entity s overseas investments.

Total gains and losses recorded in other comprehensive income includes unrealised gains and losses on debt securities held as available-for-sale within Jackson and foreign exchange movements arising from the retranslation of the Group s overseas subsidiaries and branches.

			£m							
Half year 2017	**At 1 Jan 2017**	**Total gains (losses) in income statement**	**Total gains (losses) recorded in other compre-hensive income**	**Purchases**	**Sales**	**Settled**	**Issued**	**Transfers into level 3**	**Transfers out of level 3**	**At 30 Jun 2017**
Loans	**2,699**	**96**	**(132)**	**1,879**	**-**	**(70)**	**28**	**-**	**-**	**4,500**
Equity securities and portfolio holdings in	**722**	**(17)**	**(2)**	**175**	**(418)**	**-**	**-**	**-**	**(1)**	**459**

unit trusts										
Debt securities	**942**	**2**	**(11)**	**142**	**(471)**	**-**	**-**	**-**	**(22)**	**582**
Other investments (including derivative assets)	**4,480**	**84**	**(64)**	**191**	**(227)**	**-**	**-**	**-**	**-**	**4,464**
Derivative liabilities	**(516)**	**56**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(460)**
Total financial investments, net of derivative liabilities	**8,327**	**221**	**(209)**	**2,387**	**(1,116)**	**(70)**	**28**	**-**	**(23)**	**9,545**
Borrowings attributable to with-profits operations	**-**	**2**	**-**	**-**	**-**	**-**	**(1,818)**	**-**	**-**	**(1,816)**
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	**(883)**	**(357)**	**-**	**-**	**(167)**	**1,017***	**(47)**	**-**	**-**	**(437)**
Other financial liabilities	**(2,851)**	**(96)**	**141**	**-**	**(1)**	**73**	**(32)**	**-**	**-**	**(2,766)**
Total financial instruments at fair value	**4,593**	**(230)**	**(68)**	**2,387**	**(1,284)**	**1,020**	**(1,869)**	**-**	**(23)**	**4,526**

£m

Full year 2016	**At 1 Jan 2016**	**Total gains (losses) in income statement**	**Total gains (losses) recorded in other compre-hensive income**	**Purchases**	**Sales**	**Settled**	**Issued**	**Transfers into level 3**	**Transfers out of level 3**	**At 31 Dec 2016**
Loans	2,183	2	427	-	-	(123)	210	-	-	2,699
Equity securities and portfolio holdings in unit trusts	607	59	(20)	153	(133)	(9)	-	65	-	722
Debt securities	778	85	11	185	(75)	(37)	-	-	(5)	942
Other investments (including derivative assets)	4,276	359	443	720	(1,002)	-	-	73	(389)	4,480
Derivative liabilities	(353)	(163)	-	-	-	-	-	-	-	(516)

Total financial investments, net of derivative liabilities	7,491	342	861	1,058	(1,210)	(169)	210	138	(394)	8,327
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(1,036)	(18)	(2)	-	24	271*	(122)	-	-	(883)
Other financial liabilities	(2,347)	(4)	(457)	-	-	259	(302)	-	-	(2,851)
Total financial instruments at fair value	4,108	320	402	1,058	(1,186)	361	(214)	138	(394)	4,593

* Includes distributions to third party investors by subsidiaries held by the UK with-profits funds for investment purposes. These distributions vary period to period depending on the maturity of the subsidiaries and the gains realised by those entities in the period.

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Of the total net gains and losses in the income statement of £(230) million (31 December 2016: £320 million), £(234) million (31 December 2016: £242 million) relates to net unrealised (losses) gains relating to financial instruments still held at the end of the period, which can be analysed as follows:

	2017 £m 30 Jun	**2016 £m 31 Dec**
Equity securities	**21**	8
Debt securities	**2**	71
Other investments	**42**	182
Derivative liabilities	**56**	-
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	**2**	(18)
Other financial liabilities	**(357)**	(1)
Total	**(234)**	242

Valuation approach for level 3 fair valued financial instruments

Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions, eg market illiquidity. The valuation techniques used include comparison to recent arm s length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option-adjusted spread models and, if applicable, enterprise valuation. For further detail on the valuation approach for level 3 fair valued financial instruments, please refer to note C3.1 of the Group s consolidated financial statements for the year ended 31 December 2016.

At 30 June 2017, the Group held £4,526 million (31 December 2016: £4,593 million) of net financial instruments at fair value within level 3. This represents 1 per cent (31 December 2016: 1 per cent) of the total fair valued financial assets net of fair valued financial liabilities.

The net financial instruments at fair value within level 3 at 30 June 2017 include £1,906 million of loans and a corresponding £1,816 million of borrowings held by a subsidiary of the Group s UK with-profits fund, attaching to the acquisition of a portfolio of buy-to-let mortgage loans in half year 2017 financed largely by external third party (non-recourse) borrowings (see note C3.3(c) for further details). The fair value of these loans and the related borrowings is determined by an external valuer using the income approach with the most significant inputs into the valuation being non-observable assumptions on the future level of defaults and prepayments and their effect on cash flows. The discount rate applied is updated to reflect changes in the LIBOR swap rate. The Group s exposure is limited to the investment held by the UK with-profits fund rather than to the individual loans and borrowings themselves. The fair value movements of these loans and borrowings have no effect on shareholders profit and equity.

Included within these amounts were loans of £2,594 million at 30 June 2017 (31 December 2016: £2,672 million), measured as the loan outstanding balance attached to REALIC and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,766 million at 30 June 2017 (31 December 2016: £2,851 million) was also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

Excluding the loans and funds withheld liability under REALIC s reinsurance arrangements as described above, which amounted to a net liability of £(172) million (31 December 2016: £(179) million), the level 3 fair valued financial assets net of financial liabilities were £4,698 million (31 December 2016: £4,772 million). Of this amount, a net liability of £(218) million (31 December 2016: net asset of £72 million) was internally valued, representing 0.1 per cent of the total fair valued financial assets net of financial liabilities (31 December 2016: 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net liabilities were:

(a) Debt securities of £446 million (31 December 2016: £422 million), which were either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured).

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(b) Private equity and venture investments of £176 million (31 December 2016: £956 million) which were valued internally based on management information available for these investments. These investments, in the form of debt and equity securities, were principally held by consolidated investment funds which are managed on behalf of third parties.
(c) Liabilities of £(437) million (31 December 2016: £(883) million) for the net asset value attributable to external unit holders in respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets.
(d) Derivative liabilities of £(460) million (31 December 2016: £(516) million) which are valued internally using standard market practices but are subject to independent assessment against counterparties valuations.
(e) Other sundry individual financial investments of £57 million (31 December 2016: £93 million).

Of the internally valued net liability referred to above of £(218) million (31 December 2016: net asset of £72 million):

(a) A net liability of £(97) million (31 December 2016: net asset of £315 million) was held by the Group s participating funds and therefore shareholders profit and equity are not impacted by movements in the valuation of these financial instruments.
(b) A net liability of £(121) million (31 December 2016: net liability of £(243) million) was held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally was varied downwards by 10 per cent, the change in valuation would be £12 million (31 December 2016: £24 million), which would increase (reduce) shareholders equity by this amount before tax. All this amount passes through the income statement substantially as part of short-term fluctuations in investment returns outside of operating profit.

(e) Transfers into and transfers out of levels

The Group s policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer.

During half year 2017, the transfers between levels within the Group s portfolio were primarily transfers from level 1 to 2 of £119 million and transfers from level 2 to level 1 of £400 million. These transfers, which primarily relate to debt securities, arose to reflect the change in the observability of the inputs used in valuing these securities.

In addition, the transfers out of level 3 in half year 2017 were £23 million. These transfers were primarily between levels 3 and 2 for debt securities and other investments. There were no transfers into level 3 in the period.

(f) Valuation processes applied by the Group

The Group s valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by business unit committees as part of the Group s wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions.

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C3.2 Debt securities

This note provides analysis of the Group s debt securities, including asset-backed securities and sovereign debt securities.

(a) Credit rating

Debt securities are analysed below according to external credit ratings issued, with equivalent ratings issued by different ratings agencies grouped together. Standard and Poor s ratings have been used where available, if this isn t the case Moody s and then Fitch have been used as alternatives. In the table below, AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB- ratings. Financial assets which fall outside this range are classified as below BBB-. Debt securities with no external credit rating are classified as other .

30 Jun 2017 £m	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	**3,168**	**9,722**	**3,540**	**3,201**	**1,789**	**1,978**	**23,398**
Unit-linked	**501**	**129**	**526**	**1,502**	**323**	**461**	**3,442**
Non-linked shareholder-backed	**1,138**	**2,758**	**3,035**	**2,699**	**1,645**	**946**	**12,221**
US							
Non-linked shareholder-backed	**455**	**6,739**	**10,318**	**13,526**	**1,046**	**5,945**	**38,029**
UK							
With-profits	**5,965**	**9,872**	**10,827**	**12,577**	**3,481**	**6,443**	**49,165**
Unit-linked	**597**	**2,871**	**1,131**	**1,856**	**176**	**112**	**6,743**
Non-linked shareholder-backed	**4,481**	**10,313**	**10,396**	**4,036**	**388**	**5,780**	**35,394**
Other operations	**819**	**1,275**	**192**	**95**	**14**	**6**	**2,401**
Total debt securities	**17,124**	**43,679**	**39,965**	**39,492**	**8,862**	**21,671**	**170,793**

31 Dec 2016 £m	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	3,183	8,522	3,560	2,996	1,887	1,713	21,861
Unit-linked	448	112	525	1,321	494	421	3,321
Non-linked shareholder-backed	1,082	2,435	2,864	2,388	1,680	915	11,364
US							
Non-linked shareholder-backed	445	7,932	10,609	13,950	1,009	6,800	40,745
UK							
With-profits	5,740	9,746	10,679	12,798	3,289	6,684	48,936
Unit-linked	461	2,660	1,158	1,699	212	87	6,277
Non-linked shareholder-backed	4,238	10,371	10,558	4,515	397	5,504	35,583
Other operations	830	1,190	242	97	10	2	2,371

Total debt securities	16,427	42,968	40,195	39,764	8,978	22,126	170,458

The credit ratings, information or data contained in this report which are attributed and specifically provided by S&P, Moody s and Fitch Solutions and their respective affiliates and suppliers (Content Providers) is referred to here as the Content . Reproduction of any Content in any form is prohibited except with the prior written permission of the relevant party. The Content Providers do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. The Content Providers expressly disclaim liability for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold any such investment or security, nor does it address the suitability an investment or security and should not be relied on as investment advice.

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Securities with credit ratings classified as Other can be further analysed as follows:

Asia	2017 £m 30 Jun	2016 £m 31 Dec
Non-linked shareholder-backed		
Internally rated		
Government bonds	**40**	63
Corporate bonds rated as investment grade by local external ratings agencies	**821**	757
Other	**85**	95
Total Asia non-linked shareholder-backed	**946**	915

			2017 £m	2016 £m
US	**Mortgage -backed securities**	**Other securities**	**30 Jun Total**	**31 Dec Total**
Implicit ratings of other US debt securities based on NAIC* valuations (see below)				
NAIC 1	**1,926**	**2,018**	**3,944**	4,759
NAIC 2	**10**	**1,893**	**1,903**	1,909
NAIC 3-6	**7**	**91**	**98**	132
Total US	**1,943**	**4,002**	**5,945**	6,800

* The Securities Valuation Office of the NAIC classifies debt securities into six quality categories ranging from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5 and securities in or near default are designated Class 6.

UK	2017 £m 30 Jun	2016 £m 31 Dec
Internal ratings or unrated		
AAA to A-	**7,494**	6,939
BBB to B-	**3,180**	3,257
Below B- or unrated	**1,661**	2,079
Total UK	**12,335**	12,275

In addition to the debt securities shown above, the assets held for sale on the consolidated statement of financial position at 31 December 2016 in respect of Korea life business included a debt securities balance of £652 million.

(b) Additional analysis of US insurance operations debt securities

	2017 £m	2016 £m

	30 Jun	**31 Dec**
Corporate and government security and commercial loans:		
Government	**4,884**	5,856
Publicly traded and SEC Rule 144A securities*	**24,971**	25,992
Non-SEC Rule 144A securities	**4,543**	4,576
Asset backed securities (see note (e))	**3,631**	4,321
Total US debt securities**	**38,029**	40,745

* A 1990 SEC rule that facilitates the resale of privately placed securities under Rule 144A that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

** Debt securities for US operations included in the statement of financial position comprise:

	2017 £m	**2016 £m**
	30 Jun	**31 Dec**
Available-for-sale	**37,936**	40,645
Fair value through profit and loss:		
Securities held to back liabilities for funds withheld under reinsurance arrangement	**93**	100
	38,029	40,745

Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

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(c) Movements in unrealised gains and losses on Jackson available-for-sale securities

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 £676 million to a net unrealised gain of £1,157 million as analysed in the table below.

	30 Jun 2017 £m	Foreign exchange translation**	Changes in unrealised appreciation	31 Dec 2016 £m
		Reflected as part of movement in other comprehensive income		
Assets fair valued at below book value				
Book value*	**8,760**			14,617
Unrealised gain (loss)	**(306)**	**22**	**347**	(675)
Fair value (as included in statement of financial position)	**8,454**			13,942
Assets fair valued at or above book value				
Book value*	**28,019**			25,352
Unrealised gain (loss)	**1,463**	**(72)**	**184**	1,351
Fair value (as included in statement of financial position)	**29,482**			26,703
Total				
Book value*	**36,779**			39,969
Net unrealised gain (loss)	**1,157**	**(50)**	**531**	676
Fair value (as included in the footnote above in the overview table and the statement of financial position)	**37,936**			40,645

The available-for-sale debt securities of Jackson are analysed into US Treasuries and other debt securities as follows:

US Treasuries				
Book value*	**4,415**			5,486
Unrealised gain (loss)	**(186)**	**13**	**213**	(412)
Fair value	**4,229**			5,074
Other debt securities				
Book value*	**32,364**			34,483
Unrealised gain (loss)	**1,343**	**(63)**	**318**	1,088
Fair value	**33,707**			35,571
Total debt securities				
Book value*	**36,779**			39,969
Net unrealised gain (loss)	**1,157**	**(50)**	**531**	676
Fair value	**37,936**			40,645

* Book value represents cost/amortised cost of the debt securities.

** Translated at the average rate of US$1.2599: £1.00.

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(d) US debt securities classified as available-for-sale in an unrealised loss position

(i) 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 2017 £m		31 Dec 2016 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss
Between 90% and 100%	**7,962**	**(236)**	12,326	(405)
Between 80% and 90%	**482**	**(64)**	1,598	(259)
Below 80%:				
Residential mortgage-backed securities-sub-prime	**-**	**-**	-	-
Commercial mortgage-backed securities	**-**	**-**	8	(3)
Other asset-backed securities	**10**	**(6)**	9	(8)
Government bonds	**-**	**-**	-	-
Corporates	**-**	**-**	1	-
	10	**(6)**	18	(11)
Total	**8,454**	**(306)**	13,942	(675)

(ii) Unrealised loss by maturity of security

	2017 £m 30 Jun	2016 £m 31 Dec
1 year to 5 years	**(5)**	(7)
5 year to 10 years	**(48)**	(118)
More than 10 years	**(231)**	(510)
Mortgage-backed and other debt securities	**(22)**	(40)
Total	**(306)**	(675)

(iii)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 2017 £m			31 Dec 2016 £m		
Age analysis	**Non-investment grade**	**Investment grade**	**Total**	**Non-investment grade**	**Investment grade**	**Total**
Less than 6 months	**(1)**	**(15)**	**(16)**	(3)	(599)	(602)

6 months to 1 year	**-**	**(251)**	**(251)**	-	(2)	(2)
1 year to 2 years	**(2)**	**(1)**	**(3)**	(4)	(27)	(31)
2 year to 3 years	**(3)**	**(12)**	**(15)**	(2)	(1)	(3)
More than 3 years	**(1)**	**(20)**	**(21)**	(2)	(35)	(37)
	(7)	**(299)**	**(306)**	(11)	(664)	(675)

Further, the following table shows the age analysis as at 30 June 2017 of the securities whose fair values were below 80 per cent of the book value:

	30 Jun 2017 £m		**31 Dec 2016 £m**	
Age analysis	**Fair value**	**Unrealised loss**	**Fair value**	**Unrealised loss**
Less than 3 months	**-**	**-**	1	-
3 months to 6 months	**-**	**-**	-	-
More than 6 months	**10**	**(6)**	17	(11)
	10	**(6)**	18	(11)

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(e) Asset-backed securities

The Group s holdings in asset-backed securities (ABS), which comprise residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDO) funds and other asset-backed securities, at 30 June 2017 are as follows:

	2017 £m 30 Jun	2016 £m 31 Dec
Shareholder-backed operations:		
Asia insurance operations note (i)	**104**	130
US insurance operations note (ii)	**3,631**	4,321
UK insurance operations (2017: 35% AAA, 19% AA)note (iii)	**1,045**	1,464
Asset management operations note (iv)	**665**	771
	5,445	6,686
With-profits operations:		
Asia insurance operations note (i)	**233**	357
UK insurance operations (2017: 56% AAA, 13% AA)note (iii)	**5,091**	5,177
	5,324	5,534
Total	**10,769**	12,220

Notes

(i) Asia insurance operations

The Asia insurance operations exposure to asset-backed securities is primarily held by the with-profits operations. Of the £233 million, 99 per cent (31 December 2016: 99 per cent) are investment grade.

(ii) US insurance operations

US insurance operations exposure to asset-backed securities at 30 June 2017 comprises:

	2017 £m 30 Jun	2016 £m 31 Dec
RMBS		
Sub-prime (2017: 2% AAA, 11% AA, 3% A)	**150**	180
Alt-A (2017: 3% AAA, 5% A)	**151**	177
Prime including agency (2017: 70% AA, 5% A)	**515**	675
CMBS (2017: 80% AAA, 14% AA, 1% A)	**1,768**	2,234
CDO funds (2017: 23% AAA, 8% AA, 43% A), including £nil exposure to sub-prime	**33**	50
Other ABS (2017: 17% AAA, 17% AA, 51% A), including £108 million exposure to sub-prime	**1,014**	1,005
Total	**3,631**	4,321

(iii) UK insurance operations

The majority of holdings of the shareholder-backed business are UK securities and relate to PAC s annuity business. Of the holdings of the with-profits operations, £1,473 million (31 December 2016: £1,623 million) relates to exposure to the US markets with the remaining exposure being primarily to the UK market.

(iv) Asset management operations

Asset management operations exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £665 million, 96 per cent (31 December 2016: 95 per cent) are graded AAA.

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(f) Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities at 30 June 2017:

Exposure to sovereign debts

	30 Jun 2017 £m		31 Dec 2016 £m	
	Shareholder-backed business	With-profits funds	Shareholder-backed business	With-profits funds
Italy	**57**	**62**	56	61
Spain	**33**	**18**	33	18
France	**23**	**23**	22	-
Germany*	**649**	**317**	573	329
Other Europe (principally Belgium)	**82**	**32**	83	33
Total Eurozone	**844**	**452**	767	441
United Kingdom	**4,904**	**3,049**	5,510	2,868
United States**	**4,959**	**9,913**	6,861	9,008
Other, predominantly Asia	**4,174**	**2,221**	3,979	2,079
Total	**14,881**	**15,635**	17,117	14,396

* Including bonds guaranteed by the federal government.

** The exposure to the United States sovereign debt comprises holdings of Jackson, the UK and Asia insurance operations.

Exposure to bank debt securities

	2017 £m							2016 £m
	Senior debt			Subordinated debt				
Shareholder-backed business	Covered	Senior	Total senior debt	Tier 1	Tier 2	Total subordinated debt	30 Jun Total	31 Dec Total
Italy	**-**	**32**	**32**	**-**	**-**	**-**	**32**	32
Spain	**43**	**16**	**59**	**-**	**-**	**-**	**59**	170
France	**28**	**52**	**80**	**10**	**73**	**83**	**163**	166
Germany	**76**	**4**	**80**	**-**	**87**	**87**	**167**	124
Netherlands	**-**	**67**	**67**	**-**	**6**	**6**	**73**	50
Other Eurozone	**-**	**23**	**23**	**-**	**-**	**-**	**23**	19
Total Eurozone	**147**	**194**	**341**	**10**	**166**	**176**	**517**	561
United Kingdom	**698**	**387**	**1,085**	**6**	**310**	**316**	**1,401**	1,174
United States	**-**	**2,580**	**2,580**	**3**	**174**	**177**	**2,757**	2,684
Other, predominantly Asia	**33**	**600**	**633**	**85**	**420**	**505**	**1,138**	1,018

Total	**878**	**3,761**	**4,639**	**104**	**1,070**	**1,174**	**5,813**	5,437
With-profits funds								
Italy	**-**	**65**	**65**	**-**	**-**	**-**	**65**	62
Spain	**44**	**41**	**85**	**-**	**-**	**-**	**85**	213
France	**9**	**200**	**209**	**-**	**64**	**64**	**273**	213
Germany	**112**	**20**	**132**	**-**	**35**	**35**	**167**	114
Netherlands	**-**	**192**	**192**	**5**	**7**	**12**	**204**	202
Other Eurozone	**-**	**30**	**30**	**-**	**-**	**-**	**30**	31
Total Eurozone	**165**	**548**	**713**	**5**	**106**	**111**	**824**	835
United Kingdom	**790**	**515**	**1,305**	**2**	**485**	**487**	**1,792**	1,396
United States	**-**	**1,985**	**1,985**	**16**	**333**	**349**	**2,334**	2,229
Other, predominantly Asia	**400**	**1,012**	**1,412**	**258**	**463**	**721**	**2,133**	1,992
Total	**1,355**	**4,060**	**5,415**	**281**	**1,387**	**1,668**	**7,083**	6,452

The tables above exclude assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the tables above exclude the proportionate share of sovereign debt holdings of the Group s joint venture and associate operations.

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C3.3 Loans portfolio

(a) Overview of loans portfolio

Loans are principally accounted for at amortised cost, net of impairment except for:

- Certain mortgage loans which have been designated at fair value through profit or loss of the UK insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and
- Certain policy loans of the US insurance operations which are held to back liabilities for funds withheld under a reinsurance arrangement and are also accounted for on a fair value basis.

The amounts included in the statement of financial position are analysed as follows:

	30 Jun 2017 £m				31 Dec 2016 £m			
	Mortgage loans*	**Policy loans****	**Other loans**	**Total**	**Mortgage loans***	**Policy loans****	**Other loans**	**Total**
Asia								
With-profits	**-**	**589**	**113**	**702**	-	577	113	690
Non-linked shareholder-backed	**188**	**219**	**198**	**605**	179	226	208	613
US								
Non-linked shareholder-backed	**5,964**	**3,533**	**-**	**9,497**	6,055	3,680	-	9,735
UK								
With-profits	**2,576**	**5**	**1,455**	**4,036**	668	6	1,218	1,892
Non-linked shareholder-backed	**1,711**	**-**	**37**	**1,748**	1,642	-	38	1,680
Asset management operations	**-**	**-**	**364**	**364**	-	-	563	563
Total loans securities	**10,439**	**4,346**	**2,167**	**16,952**	8,544	4,489	2,140	15,173

* All mortgage loans are secured by properties.

** In the US £2,594 million (31 December 2016: £2,672 million) policy loans are backing liabilities for funds withheld under reinsurance arrangements and are accounted for at fair value through profit or loss. All other policy loans are accounted for at amortised cost, less any impairment.

Other loans held in UK with-profits funds are commercial loans and comprise mainly syndicated loans. The majority of other loans in shareholder-backed business in Asia are commercial loans held by the Malaysia operation and which are all investment graded by two local rating agencies.

(b) Additional information on US mortgage loans

In the US, mortgage loans are all commercial mortgage loans that are secured on the following property types: industrial, multi-family residential, suburban office, retail or hotel. The US insurance operations commercial mortgage loan portfolio does not include any single-family residential mortgage loans and is therefore not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The average loan size is £12.5 million (31 December 2016: £12.4 million). The portfolio has a current estimated average loan to value of 59 per cent (31 December 2016: 59 per cent).

At 30 June 2017, Jackson had no mortgage loans where the contractual terms of the agreements had been restructured (31 December 2016: none).

(c) Additional information on UK mortgage loans

During the first half of 2017, the UK with-profits fund invested in an entity established to acquire a portfolio of buy-to-let mortgage loans. The vehicle financed the acquisition through the issue of debt instruments, largely to external parties, securitised upon the mortgages acquired. These third party borrowings have no recourse to any other assets of the Group and the Group s exposure is limited to the amount invested by the UK with-profits fund. The securitisation entity is consolidated under IFRS with the mortgage loans and the related third party non-recourse borrowings (see note C6.2 (b)) carried at fair value through profit or loss as they are managed and evaluated by the Group on a fair value basis.

By carrying value, 100 per cent of the £1,711 million (31 December 2016: 96 per cent of £1,642 million) mortgage loans held by the UK shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 30 per cent (2016: 30 per cent).

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(d) Loans held by asset management operations

These relate to loans and receivables managed by Prudential Capital. These assets are generally secured but most have no external credit ratings. Internal ratings prepared by the Group s asset management operations, as part of the risk management process, are:

	2017 £m 30 Jun	**2016 £m 31 Dec**
Loans and receivables internal ratings:		
AA+ to AA-	**21**	29
A+ to A-	**97**	100
BBB+ to BBB-	**146**	248
BB+ to BB-	**100**	185
B and other	**-**	1
Total	**364**	563

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C4 Policyholder liabilities and unallocated surplus of with-profits funds

The note provides information of policyholder liabilities and unallocated surplus of with-profits funds held on the Group s statement of financial position:

C4.1 Movement of liabilities

C4.1(a) Group overview

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

	Insurance operations £m			
	Asia**	**US**	**UK**	**Total**
Half year 2017 movements	note C4.1(b)	note C4.1(c)	note C4.1(d)	
At 1 January 2017	**62,784**	**177,626**	**169,304**	**409,714**
Comprising:				
- Policyholder liabilities on the consolidated statement of financial position	**53,716**	**177,626**	**157,654**	**388,996**
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	**2,667**	**-**	**11,650**	**14,317**
- Group s share of policyholder liabilities of joint ventures and associate	**6,401**	**-**	**-**	**6,401**
Net flows:				
Premiums	**5,699**	**8,148**	**7,756**	**21,603**
Surrenders	**(1,508)**	**(5,071)**	**(3,816)**	**(10,395)**
Maturities/deaths	**(880)**	**(1,119)**	**(3,533)**	**(5,532)**
Net flows	**3,311**	**1,958**	**407**	**5,676**
Shareholders transfers post tax	**(27)**	**-**	**(115)**	**(142)**
Investment-related items and other movements	**4,288**	**7,124**	**5,214**	**16,626**
Foreign exchange translation differences	**(2,035)**	**(8,929)**	**130**	**(10,834)**
As at 30 June 2017	**68,321**	**177,779**	**174,940**	**421,040**
Comprising:				
- Policyholder liabilities on the consolidated statement of financial position	**58,348**	**177,779**	**162,853**	**398,980**
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	**3,003**	**-**	**12,087**	**15,090**
- Group s share of policyholder liabilities of joint ventures and associate	**6,970**	**-**	**-**	**6,970**
Half year 2016 movements				
At 1 January 2016	45,966	138,913	152,893	337,772
Comprising:				
- Policyholder liabilities excluding Korea life**	38,443	138,913	142,350	319,706
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,553	-	10,543	13,096

- Group s share of policyholder liabilities of joint ventures and associate	4,970	-	-	4,970
Net flows:				
Premiums	4,191	7,101	5,561	16,853
Surrenders	(992)	(3,437)	(3,208)	(7,637)
Maturities/deaths	(671)	(809)	(3,470)	(4,950)
Net flows	2,528	2,855	(1,117)	4,266
Shareholders transfers post tax	(22)	-	(110)	(132)
Investment-related items and other movements	2,232	2,737	10,092	15,061
Foreign exchange translation differences	6,280	14,650	721	21,651
At 30 June 2016	56,984	159,155	162,479	378,618
Comprising:				
- Policyholder liabilities excluding Korea life**	48,918	159,155	151,233	359,306
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,351	-	11,246	13,597
- Group s share of policyholder liabilities of joint ventures and associate	5,715	-	-	5,715
Average policyholder liability balances*				
Half year 2017	**62,718**	**177,702**	**160,254**	**400,674**
Half year 2016**	49,023	149,034	146,792	344,849

* Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions in the period and exclude unallocated surplus of with-profits funds.

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** The sale of the Group s Korea life business was completed in May 2017. Accordingly, no amounts are shown in the half year 2017 analysis above for Korea. The half year 2016 comparatives have been correspondingly adjusted. The amounts excluded from policyholder liabilities as presented in the balance sheet are £2,812 million at 1 January 2016 and £3,204 million at 30 June 2016.
The Group s investment in joint ventures and associates are accounted for on the equity method in the Group s statement of financial position. The Group s share of the policyholder liabilities as shown above relates to life businesses in China, India and of the Takaful business in Malaysia.
The policyholder liabilities of the Asia insurance operations of £58,348 million as shown in the table above is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,271 million to the Hong Kong with-profits business.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the period. The items above are shown gross of external reinsurance.

The analysis includes the impact of premiums, claims and investment movements on policyholders liabilities. The impact does not represent premiums, claims and investment movements as reported in the income statement. For example, the premiums shown above are after any deductions for fees/charges and claims, represent the policyholder liabilities provision released rather than the claim amount paid to the policyholder.

(ii) Analysis of movements in policyholder liabilities for shareholder-backed business

	Half year 2017 £m			
	Asia	**US**	**UK**	**Total**
				note (b)
At 1 January 2017	**32,851**	**177,626**	**56,158**	**266,635**
Net flows:				
Premiums	**2,801**	**8,148**	**1,658**	**12,607**
Surrenders	**(1,335)**	**(5,071)**	**(1,500)**	**(7,906)**
Maturities/deaths	**(450)**	**(1,119)**	**(1,325)**	**(2,894)**
Net flows note (a)	**1,016**	**1,958**	**(1,167)**	**1,807**
Investment-related items and other movements	**1,912**	**7,124**	**1,500**	**10,536**
Foreign exchange translation differences	**(739)**	**(8,929)**	**-**	**(9,668)**
At 30 June 2017	**35,040**	**177,779**	**56,491**	**269,310**
Comprising:				
- Policyholder liabilities on the consolidated statement of financial position	**28,070**	**177,779**	**56,491**	**262,340**
- Group s share of policyholder liabilities relating to joint ventures and associate	**6,970**	**-**	**-**	**6,970**

	Half year 2016 £m			
	Asia	**US**	**UK**	**Total**
	note (b)			

At 1 January 2016	25,032	138,913	52,824	216,769
Net flows:				
Premiums	2,090	7,101	869	10,060
Surrenders	(829)	(3,437)	(1,311)	(5,577)
Maturities/deaths	(284)	(809)	(1,257)	(2,350)
Net flows[notes (a)(b)]	977	2,855	(1,699)	2,133
Investment-related items and other movements	841	2,737	4,285	7,863
Foreign exchange translation differences	3,294	14,650	1	17,945
At 30 June 2016	30,144	159,155	55,411	244,710
Comprising:				
- Policyholder liabilities excluding Korea life[note (b)]	24,429	159,155	55,411	238,995
- Group s share of policyholder liabilities relating to joint ventures and associate	5,715	-	-	5,715

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Note

(a) Including net flows of the Group s insurance joint ventures and associate.
(b) The sale of the Group s Korea life business was completed in May 2017. Accordingly, no amounts are shown in the half year 2017 analysis above for Korea. The half year 2016 comparatives have been correspondingly adjusted. The amounts excluded from policyholder liabilities as presented in the balance sheet are £2,812 million at 1 January 2016 and £3,204 million at 30 June 2016.

C4.1(b) Asia insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of Asia insurance operations from the beginning of the period to 30 June is as follows:

		£m		
	With-profits	Unit-linked	Other	
Half year 2017 movements	**business***	**liabilities**	**business**	**Total**
At 1 January 2017	**29,933**	**17,507**	**15,344**	**62,784**
Comprising:				
- Policyholder liabilities on the consolidated statement of financial position	**27,266**	**14,289**	**12,161**	**53,716**
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	**2,667**	**-**	**-**	**2,667**
- Group s share of policyholder liabilities relating to joint ventures and associate	**-**	**3,218**	**3,183**	**6,401**
Premiums:				
New business	**676**	**527**	**528**	**1,731**
In-force	**2,222**	**805**	**941**	**3,968**
	2,898	**1,332**	**1,469**	**5,699**
Surrenders note (c)	**(173)**	**(1,102)**	**(233)**	**(1,508)**
Maturities/deaths	**(430)**	**(82)**	**(368)**	**(880)**
Net flows note (b)	**2,295**	**148**	**868**	**3,311**
Shareholders transfers post tax	**(27)**	**-**	**-**	**(27)**
Investment-related items and other movements note (d)	**2,376**	**1,551**	**361**	**4,288**
Foreign exchange translation differences note (a)	**(1,296)**	**(373)**	**(366)**	**(2,035)**
At 30 June 2017	**33,281**	**18,833**	**16,207**	**68,321**
Comprising:				
*- Policyholder liabilities on the consolidated statement of financial position**	**30,278**	**15,326**	**12,744**	**58,348**
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	**3,003**	**-**	**-**	**3,003**
- Group s share of policyholder liabilities relating to joint ventures and associate	**-**	**3,507**	**3,463**	**6,970**

Half year 2016 movements**				
At 1 January 2016	20,934	13,779	11,253	45,966
Comprising:				
*- Policyholder liabilities excluding Korea life***	18,381	11,168	8,894	38,443
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,553	-	-	2,553
- Group s share of policyholder liabilities relating to joint ventures and associate	-	2,611	2,359	4,970
Premiums:				
New business	706	366	335	1,407
In-force	1,395	686	703	2,784
	2,101	1,052	1,038	4,191
Surrenders[note (c)]	(163)	(679)	(150)	(992)
Maturities/deaths	(387)	(27)	(257)	(671)
Net flows [note (b)]	1,551	346	631	2,528
Shareholders transfers post tax	(22)	-	-	(22)
Investment-related items and other movements[note (d)]	1,391	97	744	2,232
Foreign exchange translation differences[note (a)]	2,986	1,902	1,392	6,280
At 30 June 2016	26,840	16,124	14,020	56,984
Comprising:				
*- Policyholder liabilities excluding Korea life***	24,489	13,224	11,205	48,918
- Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,351	-	-	2,351
- Group s share of policyholder liabilities relating to joint ventures and associate	-	2,900	2,815	5,715
Average policyholder liability balances				
Half year 2017	**28,772**	**18,170**	**15,776**	**62,718**
Half year 2016**	21,435	14,951	12,637	49,023

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* The policyholder liabilities of the with-profits business of £30,278 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,271 million to the Hong Kong with-profits business.

** The sale of the Group s Korea life business was completed in May 2017. Accordingly, no amounts are shown in the half year 2017 analysis above for Korea. The half year 2016 comparatives have been correspondingly adjusted. The amounts excluded from policyholder liabilities as presented in the balance sheet are £2,812 million at 1 January 2016 and £3,204 million at 30 June 2016.

Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions in the period and exclude unallocated surplus of with-profits funds.

The Group s investment in joint ventures are accounted for on an equity method and the Group s share of the policyholder liabilities as shown above relate to the life business in China, India and of the Takaful business in Malaysia.

Notes

(a) Movements in the period have been translated at the average exchange rates for the period ended 30 June 2017. The closing balance has been translated at the closing spot rates as at 30 June 2017. Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows increased by 31 per cent from £2,528 million in half year 2016 to £3,311 million in half year 2017 predominantly reflecting continued growth of the in-force book and increased flows from new business.

(c) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 4.1 per cent in the first half of 2017 (half year 2016: 3.3 per cent).

(d) Investment-related items and other movements in the first half of 2017 primarily represent gains on equities and bonds during the period.

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C4.1(c) US insurance operations

(i) Analysis of movements in policyholder liabilities

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the period to 30 June is as follows:

US insurance operations

		£m	
Half year 2017 movements	**Variable annuity separate account liabilities**	**Fixed annuity, GIC and other business**	**Total**
At 1 January 2017	**120,411**	**57,215**	**177,626**
Premiums	**5,981**	**2,167**	**8,148**
Surrenders	**(3,409)**	**(1,662)**	**(5,071)**
Maturities/deaths	**(541)**	**(578)**	**(1,119)**
Net flows[note (b)]	**2,031**	**(73)**	**1,958**
Transfers from general to separate account	**1,240**	**(1,240)**	**-**
Investment-related items and other movements[note (c)]	**7,236**	**(112)**	**7,124**
Foreign exchange translation differences[note (a)]	**(6,183)**	**(2,746)**	**(8,929)**
At 30 June 2017	**124,735**	**53,044**	**177,779**
Half year 2016 movements			
At 1 January 2016	91,022	47,891	138,913
Premiums	4,848	2,253	7,101
Surrenders	(2,168)	(1,269)	(3,437)
Maturities/deaths	(384)	(425)	(809)
Net flows[note (b)]	2,296	559	2,855
Transfers from general to separate account	169	(169)	-
Investment-related items and other movements	843	1,894	2,737
Foreign exchange translation differences[note (a)]	9,574	5,076	14,650
At 30 June 2016	103,904	55,251	159,155
Average policyholder liability balances*			
Half year 2017	**122,573**	**55,129**	**177,702**
Half year 2016	97,463	51,571	149,034

* Averages have been based on opening and closing balances, and adjusted for any acquisitions, disposals and corporate transactions in the period.

Notes

(a)

Movements in the period have been translated at an average rate of US$1.26:£1.00 (30 June 2016: US$1.43:£1.00). The closing balance has been translated at closing rate of US$1.30:£1.00 (30 June 2016: US$1.34:£1.00). Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows in the first half of 2017 were £1,958 million (2016: £2,855 million) as we continue to grow the business with gross inflows of £8.148 million, principally into variable annuities, more than exceeding surrenders and maturities in the period.

(c) Positive investment-related items and other movements in variable annuity separate account liabilities of £7,236 million for the first six months in 2017 represents positive separate account return mainly following the increase in the US equity market in the period.

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C4.1(d) UK insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK insurance operations from the beginning of the period to 30 June is as follows:

		£m		
		Shareholder-backed funds and subsidiaries		
Half year 2017 movements	**SAIF and PAC with-profits sub-fund**	**Unit-linked liabilities**	**Annuity and other long-term business**	**Total**
At 1 January 2017	**113,146**	**22,119**	**34,039**	**169,304**
Comprising:				
- Policyholder liabilities	**101,496**	**22,119**	**34,039**	**157,654**
- Unallocated surplus of with-profits funds	**11,650**	**-**	**-**	**11,650**
Premiums	**6,098**	**1,484**	**174**	**7,756**
Surrenders	**(2,316)**	**(1,472)**	**(28)**	**(3,816)**
Maturities/deaths	**(2,208)**	**(323)**	**(1,002)**	**(3,533)**
Net flows note (a)	**1,574**	**(311)**	**(856)**	**407**
Shareholders transfers post tax	**(115)**	**-**	**-**	**(115)**
Switches	**(91)**	**91**	**-**	**-**
Investment-related items and other movements note (b)	**3,805**	**1,018**	**391**	**5,214**
Foreign exchange translation differences	**130**	**-**	**-**	**130**
At 30 June 2017	**118,449**	**22,917**	**33,574**	**174,940**
Comprising:				
- Policyholder liabilities	**106,362**	**22,917**	**33,574**	**162,853**
- Unallocated surplus of with-profits funds	**12,087**	**-**	**-**	**12,087**
Half year 2016 movements				
At 1 January 2016	100,069	21,442	31,382	152,893
Comprising:				
- Policyholder liabilities	89,526	21,442	31,382	142,350
- Unallocated surplus of with-profits funds	10,543	-	-	10,543
Premiums	4,692	527	342	5,561
Surrenders	(1,897)	(1,285)	(26)	(3,208)
Maturities/deaths	(2,213)	(271)	(986)	(3,470)
Net flows note (a)	582	(1,029)	(670)	(1,117)
Shareholders transfers post tax	(110)	-	-	(110)

Switches	(84)	84	-	-
Investment-related items and other movements[note (b)]	5,891	1,050	3,151	10,092
Foreign exchange translation differences	720	1	-	721
At 30 June 2016	107,068	21,548	33,863	162,479
Comprising:				
- *Policyholder liabilities*	95,822	21,548	33,863	151,233
- *Unallocated surplus of with-profits funds*	11,246	-	-	11,246
Average policyholder liability balances*				
Half year 2017	**103,929**	**22,518**	**33,807**	**160,254**
Half year 2016	92,674	21,495	32,623	146,792

* Averages have been based on opening and closing balances, and adjusted for any acquisitions, disposals and corporate transactions in the period, and exclude unallocated surplus of with-profits funds.

Notes

(a) Net flows have improved from a net outflow £1,117 million in the first half of 2016 to net inflows of £407 million in the same period of 2017 due primarily to higher premium flows, up by £2,195 million to £7,756 million, following increased sales of with-profits savings and retirement products. This has been partially offset by lower premiums into our annuity business due to our withdrawal from selling new annuity business. The level of inflows/outflows for unit-linked business remains subject to annual variation as it is driven by corporate pension schemes with transfers in or out from a small number of schemes influencing the level of flows in the period.

(b) Investment-related items and other movements of £5,214 million principally comprise investment return attributable to policyholders earned in the period reflecting favourable equity market movements.

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C5 Intangible assets

(a) Goodwill

	Attributable to: Shareholders	With-profits	2017 £m 30 Jun	2016 £m 31 Dec
Cost				
At beginning of year	**1,475**	**153**	**1,628**	1,648
Disposals	**-**	**(127)**	**(127)**	-
Charge for reclassification as held for sale	**-**	**-**	**-**	(56)
Additional consideration paid on previously acquired business	**-**	**-**	**-**	7
Exchange differences	**-**	**-**	**-**	29
Net book amount at end of year	**1,475**	**26**	**1,501**	1,628

Goodwill comprises:

	2017 £m 30 Jun	2016 £m 31 Dec
M&G - attributable to shareholders	**1,153**	1,153
Other - attributable to shareholders	**322**	322
Goodwill - attributable to shareholders	**1,475**	1,475
Venture fund investments - attributable to with-profits funds	**26**	153
	1,501	1,628

Other goodwill represents amounts arising from the purchase of entities by the Asia and US operations. These goodwill amounts relating to acquired operations are not individually material.

(b) Deferred acquisition costs and other intangible assets

	2017 £m 30 Jun	2016 £m 31 Dec
Deferred acquisition costs and other intangible assets attributable to shareholder	**10,643**	10,755
Deferred acquisition costs and other intangible assets attributable to with-profits funds	**114**	52
Total of deferred acquisition costs and other intangible assets	**10,757**	10,807

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

	2017 £m 30 Jun	2016 £m 31 Dec

Deferred acquisition costs related to insurance contracts as classified under IFRS 4	**9,022**	9,114
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4	**60**	64
	9,082	9,178
Present value of acquired in-force policies for insurance contracts as classified under		
IFRS 4 (PVIF)	**39**	43
Distribution rights and other intangibles	**1,522**	1,534
	1,561	1,577
Total of deferred acquisition costs and other intangible assets	**10,643**	10,755

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	2017 £m						2016 £m
	Deferred acquisition costs				PVIF and other		
				Asset	intangibles*	30 Jun	31 Dec
	Asia	US	UK	management	note	Total	Total
Balance at beginning of period:	**788**	**8,303**	**79**	**8**	**1,577**	**10,755**	8,422
Additions and acquisition of subsidiaries	**122**	**353**	**8**	**-**	**58**	**541**	1,179
Amortisation to the income statement:							
Operating profit	**(66)**	**(236)**	**(5)**	**(2)**	**(66)**	**(375)**	(686)
Non-operating profit	**-**	**231**	**-**	**-**	**(4)**	**227**	557
	(66)	**(5)**	**(5)**	**(2)**	**(70)**	**(148)**	(129)
Disposals and transfers	**-**	**-**	**-**	**-**	**-**	**-**	(268)
Exchange differences and other movements	**(21)**	**(411)**	**-**	**-**	**(4)**	**(436)**	1,475
Amortisation of DAC related to net unrealised valuation movements on Jackson s available-for-sale securities recognised within other comprehensive income	**-**	**(69)**	**-**	**-**	**-**	**(69)**	76
Balance at end of period	**823**	**8,171**	**82**	**6**	**1,561**	**10,643**	10,755

* PVIF and other intangibles includes amounts in relation to software rights with additions of £17 million, amortisation of £16 million, foreign exchange gains of £2 million and a balance at 30 June 2017 of £66 million. Under the Group s application of IFRS 4, US GAAP is used for measuring the insurance assets and liabilities of its US and certain Asia operations. Under US GAAP, most of the US insurance operation s products are accounted for under Accounting Standard no. 97 of the Financial Accounting Standards Board (FAS 97) whereby deferred acquisition costs are amortised in line with the emergence of actual and expected gross profits which are determined using an assumption for long-term investment returns for the separate account of 7.4 per cent (half year and full year 2016: 7.4 per cent) (gross of asset management fees and other charges to policyholders, but net of external fund management fees). The amounts included in the income statement and other comprehensive income affect the pattern of profit emergence and thus the DAC amortisation attaching. DAC amortisation is allocated to the operating and non-operating components of the Group s supplementary analysis of profit and other comprehensive income by reference to the underlying items.

Of the £268 million of disposals and transfers at 31 December 2016, £265 million related to the reclassification of the Korea life business as held for sale.

Note

PVIF and other intangibles comprise PVIF, distribution rights and other intangibles such as software rights. Distribution rights relate to amounts that have been paid or have become unconditionally due for payment as a result of past events in respect of bancassurance partnership arrangements in Asia. These agreements allow for bank distribution of Prudential s insurance products for a fixed period of time.

US insurance operations

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

	2017 £m 30 Jun	**2016 £m 31 Dec**
Variable annuity business	**8,133**	7,844
Other business	**330**	696
Cumulative shadow DAC (for unrealised gains/losses booked in Other Comprehensive Income)*	**(292)**	(237)
Total DAC for US operations	**8,171**	8,303

* Consequent upon the positive unrealised valuation movement for half year 2017 of £531 million (31 December 2016: negative unrealised valuation movement of £28 million), there is a charge of £69 million (31 December 2016: a gain of £76 million) for altered shadow DAC amortisation booked within other comprehensive income. These adjustments reflect the movement from period to period, in the changes to the pattern of reported gross profits that would have happened if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 30 June 2017, the cumulative shadow DAC balance as shown in the table above was negative £292 million (31 December 2016: negative £237 million).

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Sensitivity of amortisation charge

The amortisation charge to the income statement is reflected in both 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 premiums or 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 (which is used for moderating the effect of short-term volatility in investment returns) 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 the first half of 2017, the DAC amortisation charge for operating profit was determined after including a credit for decelerated amortisation of £36 million (half year 2016: £29 million). The first half of 2017 amount reflects the impact of the positive separate account performance, which is higher than 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. At 1 July 2017, it would take an instantaneous movement in separate account values of approximately more than either negative 25 per cent or positive 41 per cent for mean reversion assumption to move outside the corridor.

C6 Borrowings

C6.1 Core structural borrowings of shareholder-financed operations

	2017 £m 30 Jun	**2016 £m 31 Dec**
Holding company operations:		
Perpetual subordinated notes (Tier 1)note (i)	**847**	890
Perpetual subordinated notes (Tier 2)note (i)	**2,620**	2,754
Subordinated notes (Tier 2)note (i)	**2,131**	2,128
Subordinated debt total	**5,598**	5,772
Senior debt:note (ii)		
£300m 6.875% Bonds 2023	**300**	300
£250m 5.875% Bonds 2029	**249**	249
Holding company total	**6,147**	6,321
Prudential Capital bank loannote (iii)	**275**	275
Jackson US$250m 8.15% Surplus Notes 2027	**192**	202
Total (per condensed consolidated statement of financial position)note (iv)	**6,614**	6,798

Notes

(i) These debt tier classifications (including those noted for the comparative balances) are consistent with the treatment of capital for regulatory purposes under the Solvency II regime.
The Group has designated US$4.5 billion (31 December 2016: US$4.5 billion) of its perpetual subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the investment in Jackson.

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

(iii) The Prudential Capital bank loan of £275 million is drawn at a cost of 12 month GBP LIBOR plus 0.4 per cent and matures on 20 December 2017.

(iv) The maturity profile, currency and interest rates applicable to all other core structural borrowings of shareholder-financed operations of the Group are as detailed in note C6.1 of the Group s consolidated financial statements for the year ended 31 December 2016.

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C6.2 Other borrowings

(a) Operational borrowings attributable to shareholder-financed operations

	2017 £m 30 Jun	2016 £m 31 Dec
Borrowings in respect of short-term fixed income securities programmes	**1,424**	1,651
Other borrowings[note]	**672**	666
Total	**2,096**	2,317

Note

Other borrowings mainly include senior debt issued through the Federal Home Loan Bank of Indianapolis (FHLB), secured by collateral posted with the FHLB by Jackson. In addition, other borrowings include amounts whose repayment to the lender is contingent upon future surplus emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(b) Borrowings attributable to with-profits operations

	2017 £m 30 Jun	2016 £m 31 Dec
Non-recourse borrowings of consolidated investment funds*	**3,178**	1,189
£100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc**	**100**	100
Other borrowings (predominantly obligations under finance leases)	**58**	60
Total	**3,336**	1,349

* In all instances the holders of the debt instruments issued by these subsidiaries and funds do not have recourse beyond the assets of those subsidiaries and funds. The increase since 31 December 2016 primarily relates to the debt instruments issued by a new consolidated securitisation entity backed by a portfolio of mortgage loans (see note C3.3(c) for further details).

** The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinated to the entitlements of the policyholders of that fund.

C7 Deferred tax

The statement of financial position contains the following deferred tax assets and liabilities in relation to:

	Deferred tax assets		Deferred tax liabilities	
	2017 £m 30 Jun	2016 £m 31 Dec	2017 £m 30 Jun	2016 £m 31 Dec

Unrealised losses or gains on investments	**21**	23	**(1,774)**	(1,534)
Balances relating to investment and insurance contracts	**-**	1	**(796)**	(730)
Short-term temporary differences	**4,002**	4,196	**(3,059)**	(3,071)
Capital allowances	**16**	16	**(54)**	(35)
Unused tax losses	**66**	79		-
Total	**4,105**	4,315	**(5,683)**	(5,370)

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

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The taxation regimes applicable across the Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the recognition of deferred tax assets. For the 2017 half year results and financial position at 30 June 2017 the tax benefits on the following losses have not been recognised:

	2017 30 Jun		2016 30 Jun		2016 31 Dec	
	Tax benefit £m	**Losses £bn**	**Tax benefit £m**	**Losses £bn**	**Tax benefit £m**	**Losses £bn**
Capital losses	**90**	**0.4**	94	0.5	89	0.4
Trading losses	**48**	**0.2**	60	0.3	41	0.2

Of the unrecognised trading losses, £33 million will expire within the next seven years, the rest have no expiry date.

Under IAS 12, Income Taxes , deferred tax is measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on the tax rates (and laws) that have been enacted or are substantively enacted at the end of the reporting period.

C8 Defined benefit pension schemes

(a) IAS 19 financial positions

The Group operates a number of pension schemes. The largest defined benefit scheme is the Prudential Staff Pension Scheme (PSPS), which is the principal scheme in the UK. The Group also operates two smaller UK defined benefit schemes in respect of Scottish Amicable (SASPS) and M&G (M&GGPS). In addition, there are two small defined benefit schemes in Taiwan which have negligible deficits.

The Group asset/liability in respect of defined benefit pension schemes is as follows:

	2017 £m 30 Jun					2016 £m 31 Dec				
	PSPS	**SASPS**	**M&GGPS**	**Other Schemes**	**Total**	**PSPS**	**SASPS**	**M&GGPS**	**Other Schemes**	**Total**
Underlying economic surplus (deficit)	**753**	**(154)**	**85**	**(1)**	**683**	717	(237)	84	(1)	563
Less: unrecognised surplus	**(598)**	**-**	**-**	**-**	**(598)**	(558)	-	-	-	(558)
Economic surplus (deficit) (including investment in Prudential insurance policies)	**155**	**(154)**	**85**	**(1)**	**85**	159	(237)	84	(1)	5
Attributable to:										
PAC with-profits fund	**109**	**(62)**	**-**	**-**	**47**	111	(95)	-	-	16
Shareholder-backed operations	**46**	**(92)**	**85**	**(1)**	**38**	48	(142)	84	(1)	(11)
	-	**-**	**(145)**	**-**	**(145)**	-	-	(134)	-	(134)

Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies										
IAS 19 pension asset (liability) on the Group statement of financial position*	**155**	**(154)**	**(60)**	**(1)**	**(60)**	159	(237)	(50)	(1)	(129)

* At 30 June 2017, the PSPS pension asset of £155 million (31 December 2016: £159 million) and the other schemes pension liabilities of £215 million (31 December 2016: £288 million) are included within Other debtors and Provisions respectively in the consolidated statement of financial position.

Triennial actuarial valuations

Defined benefit schemes in the UK are generally required to be subject to full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds.

The next triennial valuation for the PSPS and SASPS are at 5 April 2017 and 31 March 2017 respectively are currently in progress. The next triennial valuation for the M&GGPS is at 31 December 2017.

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(b) Estimated pension scheme surpluses and deficits (on an economic basis)

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on consolidation in the Group financial statements) and the liabilities of the schemes. The IAS 19 basis excludes the investments in Prudential policies. In principle, on consolidation the investments are eliminated against policyholder liabilities of UK insurance operations, so that the formal IAS 19 position for the scheme in isolation excludes these items and the movements on them over the reporting periods. This treatment applies to the M&GGPS investments. However, as a substantial portion of the Company s interest in the underlying surplus of PSPS is not recognised, the adjustment is not necessary for the PSPS investments.

Movements on the pension scheme deficit determined on the economic basis are as follows, with the effect of the application of IFRIC 14 being shown separately:

	Half year 2017 £m				
	Surplus (deficit) in schemes at 1 Jan 2017	**(Charge) credit to income statement**	**Actuarial gains and losses in other comprehensive income**	**Contributions paid**	**Surplus (deficit) in schemes at 30 Jun 2017**
All schemes					
Underlying position (without the effect of IFRIC 14)					
Surplus	**563**	**(20)**	**117**	**23**	**683**
Less: amount attributable to PAC with-profits fund	**(425)**	**4**	**(57)**	**(8)**	**(486)**
Shareholders share:					
Gross of tax surplus (deficit)	**138**	**(16)**	**60**	**15**	**197**
Related tax	**(27)**	**3**	**(12)**	**(3)**	**(39)**
Net of shareholders tax	**111**	**(13)**	**48**	**12**	**158**
Application of IFRIC 14 for the derecognition of PSPS surplus					
Derecognition of surplus	**(558)**	**(7)**	**(32)**	**(1)**	**(598)**
Less: amount attributable to PAC with-profits fund	**409**	**4**	**26**	**-**	**439**
Shareholders share:					
Gross of tax	**(149)**	**(3)**	**(6)**	**(1)**	**(159)**
Related tax	**29**	**1**	**1**	**-**	**31**
Net of shareholders tax	**(120)**	**(2)**	**(5)**	**(1)**	**(128)**
With the effect of IFRIC 14					
Surplus (deficit)	**5**	**(27)**	**85**	**22**	**85**

Less: amount attributable to PAC with-profits fund	**(16)**	**8**	**(31)**	**(8)**	**(47)**
Shareholders share:					
Gross of tax surplus (deficit)	**(11)**	**(19)**	**54**	**14**	**38**
Related tax	**2**	**4**	**(11)**	**(3)**	**(8)**
Net of shareholders tax	**(9)**	**(15)**	**43**	**11**	**30**

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C9 Share capital, share premium and own shares

	30 Jun 2017			31 Dec 2016		
	Number of ordinary shares	**Share capital £m**	**Share premium £m**	**Number of ordinary shares**	**Share capital £m**	**Share premium £m**
Issued shares of 5p each fully paid:						
At 1 January	**2,581,061,573**	**129**	**1,927**	2,572,454,958	128	1,915
Shares issued under share-based schemes	**4,791,845**	**-**	**10**	8,606,615	1	12
At end of period	**2,585,853,418**	**129**	**1,937**	2,581,061,573	129	1,927

Amounts recorded in share capital represent the nominal value of the shares issued. The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued is credited to the share premium account.

At 30 June 2017, there were options outstanding under Save As You Earn schemes to subscribe for shares as follows:

	Number of shares to subscribe for	Share price range from	to	Exercisable by year
30 June 2017	**6,280,110**	**466p**	**1,155p**	**2022**
31 December 2016	7,068,884	466p	1,155p	2022

Transactions by Prudential plc and its subsidiaries in Prudential plc shares

The Group buys and sells Prudential plc shares (own shares) either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £257 million at 30 June 2017 (31 December 2016: £226 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 30 June 2017, 11.5 million (31 December 2016: 10.7 million) Prudential plc shares with a market value of £204 million (31 December 2016: £175 million) were held in such trusts, all of which are for employee incentive plans. The maximum number of shares held during the period was 15.1 million which was in March 2017.

The Company purchased the following number of shares in respect of employee incentive plans:

	Number of shares purchased	Cost £m

	(in millions)	
Half year 2017	**3.3**	**56.0**
Full year 2016	4.4	57.2

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 30 June 2017 was 6.7 million (31 December 2016: 6.0 million) and the cost of acquiring these shares of £75 million (31 December 2016: £61 million) is included in the cost of own shares. The market value of these shares as at 30 June 2017 was £120 million (31 December 2016: £97 million). During 2017, these funds made a net purchase of 678,131 Prudential shares (31 December 2016: net disposal of 77,423) for a net purchase of £13.8 million to book cost (31 December 2016: net purchase of £7.9 million).

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during half year 2017 or 2016.

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D Other notes

D1 Sale of Korea life business

On 18 May 2017, the Group announced that it had completed the sale of its life insurance subsidiary in Korea, PCA Life Insurance Co. Ltd. to Mirae Asset Life Insurance Co. Ltd., following regulatory approvals. The transaction, announced on 10 November 2016, was for a consideration of KRW170 billion (equivalent to £117 million at 17 May 2017 closing rate). The proceeds, net of £9 million of related expenses, were £108 million. This has changed by £3 million from the £105 million carrying value recorded at 31 December 2016 due to exchange rate movement.

On completion of the sale, the cumulative foreign exchange translation gain of the Korea life business of £61 million, that had arisen from 2004 (the year of the Group s conversion to IFRS) to disposal was recycled from other comprehensive income through the profit and loss account in 2017 as required by IAS 21. This amount is included within Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income in the supplementary analysis of profit of the Group as shown in note B1.1. The adjustment has no net effect on shareholders equity. The net contribution for Korea life business to the half year 2017 profit after tax is the £61 million gain for foreign exchange translation recycling with other elements in the various line items include £5 million remeasurement adjustment netting to nil.

The full year 2016 income statement recorded a charge for remeasurement of Korea Life business classified as held for sale of £(238) million. To facilitate comparisons of businesses retained by the Group, the supplementary analysis of profit shown in note B1.1 shows separately the results of the Korea life business. For full year 2016 the result for the year, including short-term fluctuations in investment returns, together with the adjustment to the carrying value gave rise to an aggregate loss of £(227) million (half year 2016: profit of £40 million).

D2 Contingencies and related obligation

In addition to the matters set out in note B4(b) in relation to the Financial Conduct Authority review of past annuity sales, the Group is involved in various litigation and regulatory issues. These may from time to time include class actions involving Jackson. While the outcome of such matters cannot be predicted with certainty, Prudential believes that the ultimate outcome of such litigation and regulatory issues will not have a material adverse effect on the Group s financial condition, results of operations or cash flows.

There have been no material changes to the Group s contingencies and related obligations in the six month period ended 30 June 2017.

D3 Post balance sheet events

First interim ordinary dividend

The 2017 first interim ordinary dividend approved by the Board of Directors after 30 June 2017 is as described in note B7.

D4 Related party transactions

There were no transactions with related parties during the six months ended 30 June 2017 which have had a material effect on the results or financial position of the Group.

The nature of the related party transactions of the Group has not changed from those described in the Group s consolidated financial statements for the year ended 31 December 2016.

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Additional IFRS financial information

I IFRS profit and loss information

I(a) Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver

This schedule classifies the Group s pre-tax operating earnings from long-term insurance operations into the underlying drivers of those profits, using the following categories:

i **Spread income** represents the difference between net investment income (or premium income in the case of the UK annuities new business) and amounts credited to certain policyholder accounts. It excludes the operating investment returns on shareholder net assets, which has been separately disclosed as **expected return on shareholder assets**.

ii **Fee income** represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.

iii **With-profits** business represents the gross of tax shareholders transfer from the with-profits fund for the period.

iv **Insurance margin** primarily represents profits derived from the insurance risks of mortality and morbidity.

v **Margin on revenues** primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.

vi **Acquisition costs and administration expenses** represent expenses incurred in the period attributable to shareholders. It excludes items such as restructuring costs and Solvency II costs which are not included in the segment profit for insurance as well as items that are more appropriately included in other source of earnings lines (eg investment expenses are netted against investment income as part of spread income or fee income as appropriate).

vii **DAC adjustments** comprises DAC amortisation for the period, excluding amounts related to short-term fluctuations in investment returns, net of costs deferred in respect of new business.

Analysis of pre-tax IFRS operating profit by source and margin analysis of Group long-term insurance business

The following analysis expresses certain of the Group s sources of operating profit as a margin of policyholder liabilities or other suitable driver. Details on the calculation of the Group s average policyholder liability balances are given in note (iv) at the end of this section.

The reconciliation of the operating profit based on longer-term investment returns by segment to profit before tax attributable to shareholders is provided in the Basis of performance measures section.

	Half year 2017					
	Asia £m	US £m	UK £m	Total £m	Average liability £m note (iv)	Margin bps note(ii)
Spread income	**108**	**401**	**74**	**583**	**89,314**	**131**
Fee income	**103**	**1,145**	**31**	**1,279**	**164,152**	**156**
With-profits	**30**	**-**	**142**	**172**	**132,701**	**26**
Insurance margin	**658**	**472**	**22**	**1,152**		
Margin on revenues	**1,056**	**-**	**82**	**1,138**		
Expenses:						
Acquisition costs[note (i)]	**(736)**	**(463)**	**(42)**	**(1,241)**	**3,624**	**(34)%**
Administration expenses	**(471)**	**(593)**	**(67)**	**(1,131)**	**259,451**	**(87)**
DAC adjustments[note (v)]	**66**	**117**	**3**	**186**		
Expected return on shareholder assets	**56**	**-**	**47**	**103**		
	870	**1,079**	**292**	**2,241**		
Longevity reinsurance and other management actions to improve solvency	**-**	**-**	**188**	**188**		
Long-term business operating profit based on longer-term investment returns	**870**	**1,079**	**480**	**2,429**		

See notes at the end of this section.

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	Half year 2016 AER					
	Asia	US	UK	Total	Average liability	Margin
	£m	£m	£m	£m	£m	bps
	note (vi)				note (iv)	note (ii)
Spread income	81	379	96	556	80,146	139
Fee income	82	878	29	989	129,054	153
With-profits	24	-	138	162	114,109	28
Insurance margin	472	401	25	898		
Margin on revenues	860	-	86	946		
Expenses:				-		
Acquisition costs note (i)	(573)	(412)	(42)	(1,027)	2,980	(34)%
Administration expenses	(369)	(452)	(58)	(879)	216,075	(81)
DAC adjustments note (v)	51	83	(2)	132		
Expected return on shareholder assets	39	11	61	111		
	667	888	333	1,888		
Longevity reinsurance and other management actions to improve solvency	-	-	140	140		
Long-term business operating profit based on longer-term investment returns	667	888	473	2,028		

See notes at the end of this section.

	Half year 2016 CER note (iii)					
	Asia	US	UK	Total	Average liability	Margin
	£m	£m	£m	£m	£m	bps
	note (vi)		note (v)		note (iv)	note (ii)
Spread income	91	426	96	613	85,708	143
Fee income	92	997	29	1,118	143,526	156
With-profits	27	-	138	165	115,945	28
Insurance margin	532	456	25	1,013		
Margin on revenues	965	-	86	1,051		
Expenses:						
Acquisition costs note (i)	(644)	(469)	(42)	(1,155)	3,296	(35)%
Administration expenses	(412)	(513)	(58)	(983)	236,974	(83)
DAC adjustments note (v)	56	95	(2)	149		
Expected return on shareholder assets	45	18	61	124		
	752	1,010	333	2,095		
Longevity reinsurance and other management actions to improve solvency	-	-	140	140		
Long-term business operating profit based on longer-term investment returns	752	1,010	473	2,235		

See notes at the end of this section.

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Margin analysis of long-term insurance business Asia

	Asia note (vi)								
	Half year 2017			Half year 2016 AER			Half year 2016 CER note (iii)		
Long-term business	**Profit** note (iv) **£m**	**Average liability** note (ii) **£m**	**Margin bps**	**Profit** note (iv) **£m**	**Average liability** note (ii) **£m**	**Margin bps**	**Profit** note (iv) **£m**	**Average liability** note (ii) **£m**	**Margin bps**
Spread income	**108**	**15,776**	**137**	81	12,637	128	91	13,886	131
Fee income	**103**	**18,170**	**113**	82	14,951	110	92	16,240	113
With-profits	**30**	**28,772**	**21**	24	21,435	22	27	23,271	23
Insurance margin	**658**			472			532		
Margin on revenues	**1,056**			860			965		
Expenses:									
Acquisition costs note (i)	**(736)**	**1,943**	**(38)%**	(573)	1,605	(36)%	(644)	1,814	(36)%
Administration expenses	**(471)**	**33,946**	**(278)**	(369)	27,588	(268)	(412)	30,126	(274)
DAC adjustments note (v)	**66**			51			56		
Expected return on shareholder assets	**56**			39			45		
Operating profit based on longer-term investment returns	**870**			667			752		

See notes at the end of this section.

Analysis of Asia operating profit drivers

Spread income has increased on a constant exchange rate basis by 19 per cent (AER: 33 per cent) to £108 million in half year 2017, predominantly reflecting the growth of the Asia non-linked policyholder liabilities.

Fee income has increased by 12 percent at constant exchange rates (AER: 26 per cent) to £103 million in half year 2017, broadly in line with the increase in movement in average unit-linked liabilities.

On a constant exchange rate basis, insurance margin has increased by 24 per cent to £658 million in half year 2017 (AER: 39 per cent), primarily reflecting the continued growth of the in-force book, which contains a relatively high proportion of risk-based products. Insurance margin includes non-recurring items of £66 million (half year 2016: £42 million at AER and £46 million at CER).

Margin on revenue has increased by £91 million on a constant exchange rate basis from £965 million in half year 2016 to £1,056 million in half year 2017, primarily reflecting growth of the in-force book and higher regular premium income recognised in the period.

Acquisition costs have increased by 14 per cent at constant exchange rates (AER: 28 per cent) to £736 million, compared to the 7 per cent increase in APE sales, resulting in an increase in the acquisition costs ratio. The analysis above uses shareholder acquisition costs as a proportion of total APE. If with-profits sales were excluded from the denominator the acquisition cost ratio would become 65 per cent (half year 2016: 72 per cent at CER), the decrease being the result of product and country mix.

Administration expenses have increased by 14 per cent at a constant exchange rate basis (AER: 28 per cent increase) in half year 2017 as the business continues to expand. On a constant exchange rate basis, the administration expense ratio has increased from 274 basis points in half year 2016 to 278 basis points in half year 2017, the result of changes in country and product mix.

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Margin analysis of long-term insurance business US

	US								
	Half year 2017			**Half year 2016 AER**			**Half year 2016 CER** note (iii)		
	Profit	**Average liability** note (iv)	**Margin** note (ii)	**Profit**	**Average liability** note (iv)	**Margin** note (ii)	**Profit**	**Average liability** note (iv)	**Margin** note (ii)
Long-term business	**£m**	**£m**	**bps**	**£m**	**£m**	**bps**	**£m**	**£m**	**bps**
Spread income	**401**	**39,731**	**202**	379	34,886	217	426	39,199	217
Fee income	**1,145**	**123,464**	**186**	878	92,608	190	997	105,791	188
Insurance margin	**472**			401			456		
Expenses:									
Acquisition costs note (i)	**(463)**	**960**	**(48)%**	(412)	782	(53)%	(469)	889	(53)%
Administration expenses	**(593)**	**169,180**	**(70)**	(452)	134,369	(67)	(513)	152,730	(67)
DAC adjustments	**117**			83			95		
Expected return on shareholder assets	**-**			11			18		
Operating profit based on longer-term investment returns	**1,079**			888			1,010		

See notes at the end of this section.

Analysis of US operating profit drivers:

Spread income has decreased by 6 per cent at constant exchange rates (AER: increased by 6 per cent) to £401 million in the first half of 2017. The reported spread margin decreased to 202 basis points from 217 basis points in the first half of 2016, due to lower investment yields. Spread income benefited from swap transactions previously entered into to more closely match the asset and liability duration. Excluding this effect, the spread margin would have been 147 basis points (half year 2016 CER: 150 basis points and AER: 151 basis points).

Fee income has increased by 15 per cent at constant exchange rates (AER: increased by 30 per cent) to £1,145 million during the first half of 2017, primarily due to higher average separate account balances resulting from positive net cash flows from variable annuity business and market appreciation.

Insurance margin represents operating profits from insurance risks, including variable annuity guarantees and other sundry items. Insurance margin increased to £472 million in the first half of 2017 compared to £456 million at constant exchange rates at half year 2016. The increase was primarily due to higher income from variable annuity guarantees partially offset by a decline in the contribution from the closed books of business.

Acquisition costs, which are commissions and expenses incurred to acquire new business, including those that are not deferrable, have decreased in absolute terms and as a percentage of APE compared to the first half of 2016 at constant exchange rates. This is due to the continued increase in producers selecting asset-based commissions which are paid upon policy anniversary dates and are treated as an administrative expense in this analysis, rather than front-end commissions and the result of change in product mix.

Administration expenses increased to £593 million during the first half of 2017, compared to £513 million for the first half of 2016 at a constant exchange rate (AER: £452 million), primarily as a result of higher asset-based

commissions. Excluding these trail commissions, the resulting administration expense ratio would remain flat at 36 basis points (half year 2016: 36 basis points at CER and AER).
DAC adjustments increased to £117 million during the first half of 2017, compared to £95 million at a constant exchange rate (AER: £83 million) during the first half of 2016, primarily due to lower DAC amortisation due to higher fund returns.

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Analysis of pre-tax operating profit before and after acquisition costs and DAC adjustments

	Half year 2017 £m				**Half year 2016 AER £m**				**Half year 2016 CER £m** note (iii)			
		Acquisition costs				**Acquisition costs**				**Acquisition costs**		
	Other operating profits	**Incurred**	**Deferred**	**Total**	**Other operating profits**	**Incurred**	**Deferred**	**Total**	**Other operating profits**	**Incurred**	**Deferred**	**Total**
Total operating profit before acquisition costs and DAC adjustments	**1,425**			**1,425**	1,217			1,217	1,384			1,384
Less new business strain		**(463)**	**353**	**(110)**		(412)	320	(92)		(469)	364	(105)
Other DAC adjustments-amortisation of previously deferred acquisition costs:												
Normal			**(272)**	**(272)**			(266)	(266)			(303)	(303)
Deceleration			**36**	**36**			29	29			34	34
Total	**1,425**	**(463)**	**117**	**1,079**	1,217	(412)	83	888	1,384	(469)	95	1,010

Analysis of operating profit based on longer-term investment returns for US operations by product

	2017 £m	**2016 £m**		**%**	
		AER	**CER**	**Half year 2017 vs Half year 2016**	**Half year 2017 vs half year 2016**
	Half year	**Half year**	**Half year**	**AER**	**CER**
Spread business[note (a)]	**176**	154	175	14%	1%
Fee business[note (b)]	**852**	642	730	33%	17%
Life and other business[note (c)]	**51**	92	105	(45)%	(51)%
Total insurance operations	**1,079**	888	1,010	22%	7%
US asset management and broker-dealer	**(6)**	(12)	(13)	50%	54%
Total US operations	**1,073**	876	997	22%	8%

The analysis of operating profit based on longer-term investment returns for US operations by product represents the net profit generated by each line of business after allocation of costs. Broadly:

a) Spread business is the net operating profit for fixed annuity, fixed indexed annuity and guaranteed investment contracts and largely comprises spread income less costs.

b) Fee business represents profits from variable annuity products. As well as fee income revenue for this product line includes spread income from investments directed to the general account and other variable annuity fees included in insurance margin.

c) Life and other business includes the profits from the REALIC business and other closed life books. Revenue allocated to this product line includes spread income and premiums and policy charges for life protection, which are included in insurance margin after claim costs. Insurance margin forms the vast majority of revenue.

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Margin analysis of long-term insurance business UK

	UK					
	Half year 2017			Half year 2016		
	Profit	Average liability note (iv)	Margin note (ii)	Profit	Average liability note (iv)	Margin note (ii)
Long-term business	£m	£m	bps	£m	£m	bps
Spread income	**74**	**33,807**	**44**	96	32,623	59
Fee income	**31**	**22,518**	**27**	29	21,495	27
With-profits	**142**	**103,929**	**27**	138	92,674	30
Insurance margin	**22**			25		
Margin on revenues	**82**			86		
Expenses:						
Acquisition costs note (i)	**(42)**	**721**	**(6)%**	(42)	593	(7)%
Administration expenses	**(67)**	**56,325**	**(24)**	(58)	54,118	(21)
DAC adjustments	**3**			(2)		
Expected return on shareholders assets	**47**			61		
	292			333		
Longevity reinsurance and other management actions to improve solvency	**188**			140		
Operating profit based on longer-term investment returns	**480**			473		

Analysis of UK operating profit drivers

Spread income has decreased from £96 million in half year 2016 to £74 million in half year 2017 mainly due to lower annuity sales. Spread income has two components:

A contribution from new annuity business which was lower at £4 million in half year 2017 compared to £27 million in half year 2016, reflecting our withdrawal from this market.

A contribution from in-force annuity and other business, which was broadly in line with last year at £70 million (half year 2016: £69 million), equivalent to 41 basis points of average reserves (half year 2016: 42 basis points).

Fee income principally represents asset management fees from unit-linked business, including direct investment only business to group pension schemes, where liability flows are driven by a small number of large single mandate transactions and fee income mostly arise within our UK asset management business. Excluding these schemes, the fee margin on the remaining balance was 40 basis points (half year 2016: 40 basis points).

Margin on revenues represents premium charges for expenses of shareholder-backed business and other sundry net income.

Acquisition costs incurred were £42 million, equivalent to 6 per cent of total APE sales in half year 2017 (half year 2016: 7 per cent). The ratio above expresses the percentage of shareholder acquisition costs as a percentage of total APE sales. It is therefore impacted by the level of with-profit sales in the year. Acquisition costs as a percentage of shareholder-backed new business sales were 32 per cent in half year 2017 (half year 2016: 33 per cent).

The contribution from longevity reinsurance and other management actions to improve solvency during half year 2017 was £188 million (half year 2016: £140 million). Further explanation and analysis is provided in Additional Financial Information
section I(d).

Notes on analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver

(i) The ratio for acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business. APE is defined under the section EEV Basis, New Business Results and Free Surplus Generation in this document.

(ii) Margin represents the operating return earned in the period as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus. The margin is on an annualised basis in which half year profits are annualised by multiplying by two.

(iii) The half year 2016 comparative information has been presented at Actual Exchange Rates (AER) and Constant Exchange Rates (CER) so as to eliminate the impact of exchange translation. CER results are calculated by translating prior period results using the current period foreign exchange rates. All CER profit figures have been translated at current

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period average rates. For Asia CER average liability calculations the policyholder liabilities have been translated using current period opening and closing exchange rates. For the US CER average liability calculations the policyholder liabilities have been translated at the current period month end closing exchange rates.

(iv) For UK and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the period, as a proxy for average balances throughout the period. The calculation of average liabilities for Jackson is generally derived from month end balances throughout the period as opposed to opening and closing balances only. The average liabilities for fee income in Jackson have been calculated using daily balances instead of month end balances in order to provide a more meaningful analysis of the fee income, which is charged on the daily account balance. Average liabilities for spread income are based on the general account liabilities to which spread income attaches. Average liabilities used to calculate the administration expense margin exclude the REALIC liabilities reinsured to third parties prior to the acquisition by Jackson. Average liabilities are adjusted for business acquisitions and disposals in the period.

(v) The DAC adjustment contains £10 million in respect of joint ventures and associate in half year 2017 (half year 2016: £14 million).

(vi) Following its sale in May 2017, the half year 2016 comparative operating result has been adjusted to exclude the result attributable to the sold Korean life business. This approach is consistent with that applied at full year 2016.

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I(b) Asia operations analysis of IFRS operating profit by business unit

Operating profit based on longer-term investment returns for Asia operations are analysed below. The table below presents the half year 2016 results on both actual exchange rates (AER) and constant exchange rates (CER) bases so as to eliminate the impact of exchange translation.

	2017 £m	2016 £m		%	
				Half year 2017 vs half year 2016	Half year 2017 vs half year 2016
		AER	CER		
	Half year	Half year	Half year	AER	CER
Hong Kong	**157**	96	109	64%	44%
Indonesia	**232**	193	221	20%	5%
Malaysia	**86**	71	76	21%	13%
Philippines	**21**	17	18	24%	17%
Singapore	**133**	111	125	20%	6%
Thailand	**46**	39	44	18%	5%
Vietnam	**57**	44	49	30%	16%
South-east Asia Operations inc. Hong Kong	**732**	571	642	28%	14%
China	**39**	20	21	95%	86%
Taiwan	**19**	13	17	46%	12%
Other	**27**	23	28	17%	(4)%
Non-recurrent items[note (ii)]	**54**	42	46	29%	17%
Total insurance operations[note (i)]	**871**	669	754	30%	16%
Development expenses	**(1)**	(2)	(2)	50%	50%
Total long-term business operating profit based on longer-term investment returns	**870**	667	752	30%	16%
Eastspring Investments	**83**	61	69	36%	20%
Total Asia operations	**953**	728	821	31%	16%

* Following its sale in May 2017, the half year 2016 comparative operating result has been adjusted to exclude the result attributable to the sold Korea life business. This approach is consistent with that applied at full year 2016.

Notes

(i) Analysis of operating profit between new and in force business

The result for insurance operations comprises amounts in respect of new business and business in force as follows:

	2017 £m	2016 £m	
	Half year	AER	CER

		Half year	Half year
New business strain	**(40)**	(17)	(19)
Business in force	**857**	644	727
Non-recurrent items[note (ii)]	**54**	42	46
Total	**871**	669	754

The IFRS new business strain corresponds to approximately (2.0) per cent of new business APE sales for half year 2017 (half year 2016: approximately (1.1) per cent). APE is defined under the section EEV Basis, New Business Results and Free Surplus Generation in this document.

The strain represents the pre-tax regulatory basis strain to net worth after IFRS adjustments; for deferral of acquisition costs and deferred income where appropriate.

(ii) Other non-recurrent items of £54 million in 2017 (half year 2016: £42 million) represent a small number of items.

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I(c) Analysis of asset management operating profit based on longer-term investment returns

	Half year 2017 £m				
		Eastspring	Prudential		
	M&G	**Investments**	**Capital**	**US**	**Total**
	note (ii)	note (ii)			
Operating income before performance-related fees	**495**	**205**	**56**	**124**	**880**
Performance-related fees	**6**	**3**	**-**	**-**	**9**
Operating income(net of commission)note (i)	**501**	**208**	**56**	**124**	**889**
Operating expensenote (i)	**(261)**	**(113)**	**(50)**	**(130)**	**(554)**
Share of associate s results	**8**	**-**	**-**	**-**	**8**
Group s share of tax on joint ventures operating profit	**-**	**(12)**	**-**	**-**	**(12)**
Operating profit/(loss) based on longer-term investment returns	**248**	**83**	**6**	**(6)**	**331**
Average funds under management	**£ 267.2bn**	**£ 124.9bn**			
Margin based on operating income*	**37bps**	**33bps**			
Cost / income ratio**	**53%**	**55%**			

	Half year 2016 £m				
		Eastspring	Prudential		
	M&G	**Investments**	**Capital**	**US**	**Total**
	note (ii)	note (ii)			
Operating income before performance-related fees	440	155	61	109	765
Performance-related fees	9	1	-	-	10
Operating income(net of commission)note (i)	449	156	61	109	775
Operating expensenote (i)	(229)	(87)	(48)	(121)	(485)
Share of associate s results	5	-	-	-	5
Group s share of tax on joint ventures operating profit	-	(8)	-	-	(8)
Operating profit based on longer-term investment returns	225	61	13	(12)	287
Average funds under management	£ 243.2bn	£ 102.2bn			
Margin based on operating income*	36bps	30bps			
Cost / income ratio**	52%	56%			

Notes

(i) Operating income and expense include the Group s share of contribution from joint ventures (but excludes any contribution from associates). In the income statement as shown in note B2 to the unaudited condensed consolidated interim financial statements, the net post-tax income of the joint ventures and associates is shown as a single item.

(ii) M&G and Eastspring Investments can be further analysed as follows:

M&G Operating income before performance-related fees	Retail £m	Margin of FUM* bps	Institutional £m	Margin of FUM* bps	Total £m	Margin of FUM* bps
30 Jun 2017	**285**	**86**	**210**	**21**	**495**	**37**
30 Jun 2016	247	87	193	21	440	36

Eastspring Investments Operating income before performance-related fees	Retail £m	Margin of FUM* bps	Institutional £m	Margin of FUM* bps	Total £m	Margin of FUM* bps
30 Jun 2017	**120**	**57**	**85**	**20**	**205**	**33**
30 Jun 2016	91	53	64	19	155	30

* Margin represents operating income before performance related fees as a proportion of the related funds under management (FUM). Half year figures have been annualised by multiplying by two. Monthly closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group s insurance operations which are managed by third parties outside of the Prudential Group are excluded from these amounts.

** Cost/income ratio represents cost as a percentage of operating income before performance related fees. Institutional includes internal funds.

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I(d) Contribution to UK life IFRS financial metrics from specific management actions undertaken to position the balance sheet more efficiently under the Solvency II regime

In the first half of 2017, further management actions were taken to improve the solvency of UK insurance operations and to mitigate market risks. These actions included extending the reinsurance of longevity risk to cover a further £0.6 billion of IFRS annuity liabilities. As at 30 June 2017 the total IFRS annuity liabilities subject to longevity reinsurance were £14.8 billion. Management actions also repositioned the fixed income asset portfolio to improve the trade-off between yield and credit risk.

The effect of these actions on the UK s long term IFRS operating profit based on longer-term investment returns is shown in the tables below.

	IFRS operating profit based on longer-term investment returns of UK long-term business	
	Half year 2017	**Half year 2016**
Shareholder-backed annuity new business:		
Retail	**4**	27
Bulks	**-**	-
	4	27
In-force business:		
Longevity reinsurance transactions	**31**	66
Other management actions to improve solvency	**157**	74
Provision for the review of past annuity sales	**-**	-
	188	140
With-profits and other in-force	**288**	306
Total Life IFRS operating profit	**480**	473

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II Other information

II(a) Funds under management

For our asset management businesses, funds managed on behalf of third parties are not recorded on the balance sheet. They are however a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing on those which are external to the Group and those held by the insurance businesses and included on the Group balance sheet. This is analysed below.

(a) Summary

	2017 £bn 30 Jun	**2016 £bn 31 Dec**
Business area:		
Asia operations	**75.8**	69.6
US operations	**174.6**	173.3
UK operations	**193.8**	185.0
Prudential Group funds under management note (i)	**444.2**	427.9
External funds note (ii)	**190.7**	171.4
Total funds under management	**634.9**	599.3

Notes

(i) Prudential Group funds under management comprise:

	2017 £bn 30 Jun	**2016 £bn 31 Dec**
Total financial investments per the consolidated statement of financial position	**437.4**	421.7
Less: investments in joint ventures and associates accounted for using the equity method	**(1.3)**	(1.2)
Internally managed funds held in joint ventures	**7.7**	7.0
Investment properties which are held for sale or occupied by the Group (included in other IFRS captions)	**0.4**	0.4
Prudential Group funds under management	**444.2**	427.9

(ii) External funds shown above as at 30 June 2017 of £190.7 billion (31 December 2016: £171.4 billion) comprise £202.0 billion (31 December 2016: £182.5 billion) of funds managed by M&G and Eastspring Investments as shown in note (b) below less £11.3 billion (31 December 2016: £11.1 billion) that are classified within Prudential Group s funds.

(b) Investment products external funds under management

	Half year 2017 £m			Full year 2016 £m		
	Eastspring Investments note	**M&G**	**Group total** note	**Eastspring Investments** note	**M&G**	**Group total** note
At beginning of period	**45,756**	**136,763**	**182,519**	36,287	126,405	162,692
Market gross inflows	**108,240**	**22,677**	**130,917**	164,004	22,841	186,845
Redemptions	**(105,468)**	**(15,498)**	**(120,966)**	(161,766)	(30,931)	(192,697)
Market exchange translation and other movements	**4,395**	**5,176**	**9,571**	7,231	18,448	25,679
At end of period	**52,923**	**149,118**	**202,041**	45,756	136,763	182,519

Note

The £202.0 billion (31 December 2016: £182.5 billion) investment products comprise £193.7 billion (31 December 2016: £174.8 billion) plus Asia Money Market Funds of £8.3 billion (31 December 2016: £7.7 billion).

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(c) M&G and Eastspring Investments total funds under management

	Eastspring Investments note		M&G	
	2017 £bn	**2016 £bn**	**2017 £bn**	**2016 £bn**
	30 Jun	**31 Dec**	**30 Jun**	**31 Dec**
External funds under management	**52.9**	45.7	**149.1**	136.8
Internal funds under management	**77.6**	72.2	**132.4**	128.1
Total funds under management	**130.5**	117.9	**281.5**	264.9

Note

The external funds under management for Eastspring Investments include Asia Money Market Funds at 30 June 2017 of £8.3 billion (31 December 2016: £7.7 billion).

II(b) Solvency II capital position at 30 June 2017

The estimated Group shareholder Solvency II surplus at 30 June 2017 was £12.9 billion, before allowing for payment of the 2017 first interim dividend and after allowing for management s estimate of transitional measures reflecting operating and market conditions as at 30 June 2017.

Estimated Group shareholder Solvency II capital position*	**30 Jun 2017 £bn**	**30 Jun 2016 £bn**	**31 Dec 2016 £bn**
Own funds	25.6	21.1	24.8
Solvency capital requirement	12.7	12.0	12.3
Surplus	**12.9**	**9.1**	**12.5**
Solvency ratio	202%	175%	201%

* The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced With-Profit Funds and staff pension schemes in surplus. The solvency positions include management s estimates of UK transitional measures reflecting operating and market conditions at each valuation date.

In accordance with Solvency II requirements, these results allow for:

- Capital in Jackson in excess of 250 per cent of the US local Risk Based Capital requirement. As agreed with the Prudential Regulation Authority, this is incorporated in the result above as follows:
  - Own funds: represents Jackson s local US Risk Based available capital less 100 per cent of the US Risk Based Capital requirement (Company Action Level);
  - Solvency Capital Requirement: represents 150 per cent of Jackson s local US Risk Based Capital requirement (Company Action Level); and
  - No diversification benefits are taken into account between Jackson and the rest of the Group.
- Matching adjustment for UK annuities and volatility adjustment for US dollar denominated Hong Kong with-profits business, based on approvals from the Prudential Regulation Authority and calibrations published by

the European Insurance and Occupational Pensions Authority; and

UK transitional measures, which have been recalculated using management s estimate of the impact of operating and market conditions at the valuation date. The estimated Group shareholder surplus would increase from £12.9 billion to £13.6 billion at 30 June 2017 if the approved regulatory transitional amount was applied instead.

The Group shareholder Solvency II capital position excludes:

A portion of Solvency II surplus capital (£1.6 billion at 30 June 2017) relating to the Group s Asian life operations, including due to contract boundaries ;

The contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds in surplus (representing £4.1 billion of surplus capital from UK with-profits funds at 30 June 2017) and from the shareholders share of the estate of with-profits funds; and

The contribution to Own Funds and the Solvency Capital Requirement from pension funds in surplus.

It also excludes unrealised gains on certain derivative instruments taken out to protect Jackson against declines in long-term interest rates. At Jackson s request, the Department of Insurance Financial Services renewed its approval to carry these instruments at book value in the local statutory returns for the period 31 December 2016 to 1 October 2017. At 30 June 2017, this approval had the effect of decreasing local statutory capital and surplus (and by extension Solvency II Own Funds and Solvency II surplus) by £0.4 billion, net of tax. This arrangement reflects an elective longstanding practice first put in place in 2009, which can be unwound at Jackson s discretion.

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The 30 June 2017 Solvency II results above allow for the completion of the sale of the Korea life business in the first half of 2017.

Further information on the Solvency II capital position for the Group and The Prudential Assurance Company Limited is published annually in the Solvency and Financial Condition Reports. These were last published on the Group s website on 18 May 2017.

Analysis of movement in Group capital position

A summary of the estimated movement in Group Solvency II surplus from £12.5 billion at year end 2016 to £12.9 billion at half year 2017 is set out in the table below. The movement from the Group Solvency II surplus at 31 December 2015 to the Solvency II surplus at 30 June 2016 and 31 December 2016 is included for comparison.

Analysis of movement in Group shareholder surplus	Half year 2017 £bn Surplus	Half year 2016 £bn Surplus	Full year 2016 £bn Surplus
Estimated Solvency II surplus at 1 January 2017 / 1 January 2016	**12.5**	**9.7**	**9.7**
Underlying operating experience	1.5	1.0	2.3
Management actions	0.2	0.2	0.4
Operating experience	1.7	1.2	2.7
Non-operating experience (including market movements)	0.0	(2.4)	(1.1)
Other capital movements			
Subordinated debt issuance	-	0.7	1.2
Foreign currency translation impacts	(0.5)	0.9	1.6
Dividends paid	(0.8)	(0.9)	(1.3)
Model changes	0.0	(0.1)	(0.3)
Estimated Solvency II surplus at end period	**12.9**	**9.1**	**12.5**

The estimated movement in Group Solvency II surplus in the first half of 2017 is driven by:

Operating experience of £1.7 billion: generated by in-force business and new business written in 2017, after allowing for amortisation of the UK transitional and the impact of one-off management optimisations implemented over the period;
Non-operating experience: has been neutral overall during the first half of 2017, after allowing for the recalculation of the UK transitional at the valuation date; and
Other capital movements: comprising a loss from foreign currency translation in the first half of 2017 and a reduction in surplus from payment of dividends.

Analysis of Group Solvency Capital Requirements

The split of the Group s estimated Solvency Capital Requirement by risk type including the capital requirements in respect of Jackson s risk exposures based on 150 per cent of US Risk Based Capital requirements (Company Action Level) but with no diversification between Jackson and the rest of the Group, is as follows:

Split of the Group s estimated Solvency Capital Requirements	30 Jun 2017 % of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements	31 Dec 2016 % of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements
Market	**56%**	**71%**	**55%**	**68%**
Equity	13%	21%	12%	19%
Credit	25%	40%	25%	41%
Yields (interest rates)	14%	8%	13%	7%
Other	4%	2%	5%	1%
Insurance	**27%**	**21%**	**28%**	**23%**
Mortality/morbidity	5%	2%	5%	2%
Lapse	16%	17%	16%	19%
Longevity	6%	2%	7%	2%
Operational/expense	**10%**	**6%**	**11%**	**7%**
FX translation	**7%**	**2%**	**6%**	**2%**

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Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds

Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds	30 Jun 2017 £bn	30 Jun 2016 £bn	31 Dec 2016 £bn
IFRS shareholders equity	**15.4**	**14.6**	**14.7**
Restate US insurance entities from IFRS onto local US statutory basis	(2.6)	(3.1)	(2.2)
Remove DAC, goodwill and intangibles	(3.9)	(3.9)	(3.8)
Add subordinated debt	6.1	5.7	6.3
Impact of risk margin (net of transitionals)	(3.6)	(3.3)	(3.4)
Add value of shareholder transfers	4.6	3.1	4.0
Liability valuation differences	10.7	9.7	10.5
Increase in value of net deferred tax liabilities (resulting from valuation differences above)	(1.4)	(1.2)	(1.3)
Other	0.3	(0.5)	0.0
Estimated Solvency II Shareholder Own Funds	**25.6**	**21.1**	**24.8**

The key items of the reconciliation as at 30 June 2017 are:

£(2.6) billion represents the adjustment required to the Group s shareholders funds in order to convert Jackson s contribution from an IFRS basis to the local statutory valuation basis. This item also reflects a derecognition of Own Funds of £0.8 billion, equivalent to the value of 100 per cent of Risk Based Capital requirements (Company Action Level), as agreed with the Prudential Regulation Authority;

£(3.9) billion due to the removal of DAC, goodwill and intangibles from the IFRS balance sheet;

£6.1 billion due to the addition of subordinated debt which is treated as available capital under Solvency II but as a liability under IFRS;

£(3.6) billion due to the inclusion of a risk margin for UK and Asia non-hedgeable risks, net of £2.1 billion from transitional measures (after recalculation for management s estimate of the impact of operating and market conditions on the UK transitional as at 30 June 2017), all of which are not applicable under IFRS;

£4.6 billion due to the inclusion of the value of future shareholder transfers from with-profits business (excluding the shareholders share of the with-profits estate, for which no credit is given under Solvency II), which is excluded from the determination of the Group s IFRS shareholders funds;

£10.7 billion due to differences in insurance valuation requirements between Solvency II and IFRS, with Solvency II Own Funds partially capturing the value of in-force business which is excluded from IFRS;

£(1.4) billion due to the impact on the valuation of deferred tax assets and liabilities resulting from the other valuation differences noted above; and

£0.3 billion due to other items, including the impact of revaluing loans, borrowings and debt from IFRS to Solvency II.

Sensitivity analysis

The estimated sensitivity of the Group shareholder Solvency II capital position to significant changes in market conditions is as follows:

Impact of market sensitivities	30 Jun 2017		31 Dec 2016	
	Surplus £bn	Ratio	Surplus £bn	Ratio

Base position	**12.9**	**202%**	**12.5**	**201%**
Impact of:				
20% instantaneous fall in equity markets	0.1	4%	0.0	3%
40% fall in equity markets[1]	(1.2)	(3)%	(1.5)	(7)%
50 basis points reduction in interest rates[2,3]	(0.4)	(9)%	(0.6)	(9)%
100 basis points increase in interest rates[3]	0.9	18%	1.0	13%
100 basis points increase in credit spreads[4]	(1.1)	(3)%	(1.1)	(3)%

1 *Where hedges are dynamic, rebalancing is allowed for by assuming an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four-week period.*

2 *Subject to a floor of zero.*

3 *Allowing for further transitional recalculation after the interest rate stress.*

4 *US Risk Based Capital solvency position included using a stress of 10 times expected credit defaults.*

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The Group is positioned to withstand significant deteriorations in market conditions and we continue to use market hedges to manage some of this exposure across the Group, where we believe the benefit of the protection outweighs the cost. The sensitivity analysis above allows for predetermined management actions and those taken to date, but does not reflect all possible management actions which could be taken in the future.

UK Solvency II capital position[1, 2]

On the same basis as above, the estimated UK shareholder Solvency II surplus at 30 June 2017 was £5.3 billion, after allowing for management s estimate of transitional measures reflecting operating and market conditions as at 30 June 2017. This relates to shareholder-backed business including future with-profits shareholder transfers, but excludes the shareholders share of the estate in line with Solvency II requirements.

Estimated UK shareholder Solvency II capital position*	30 Jun 2017 £bn	30 Jun 2016 £bn	31 Dec 2016 £bn
Own funds	13.0	10.6	12.0
Solvency capital requirement	7.7	7.7	7.4
Surplus	**5.3**	**2.9**	**4.6**
Solvency ratio	168%	138%	163%

* *The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced With-Profit Funds and staff pension schemes in surplus.* The solvency positions include management s estimate of UK transitional measures reflecting operating and market conditions at each valuation date. The estimated UK shareholder surplus would increase from £5.3 billion to £6.0 billion at 30 June 2017 if the approved regulatory transitional amount was applied instead.

While the surplus position of the UK with-profits funds remains strong on a Solvency II basis, it is ring-fenced from the shareholder balance sheet and is therefore excluded from both the Group and the UK shareholder Solvency II surplus results. The estimated UK with-profits funds Solvency II surplus at 30 June 2017 was £4.1 billion, after allowing for management s estimate of transitional measures reflecting operating and market conditions as at 30 June 2017.

Estimated UK with-profits Solvency II capital position	30 Jun 2017 £bn	30 Jun 2016 £bn	31 Dec 2016 £bn
Own funds	8.6	8.2	8.4
Solvency capital requirement	4.5	4.7	4.7
Surplus	**4.1**	**3.5**	**3.7**
Solvency ratio	192%	176%	179%

Reconciliation of UK with-profits IFRS unallocated surplus to Solvency II Own Funds[2]

A reconciliation between the IFRS unallocated surplus and Solvency II Own Funds for UK with-profits business is as follows:

Reconciliation of UK with-profits funds	30 Jun 2017 £bn	30 Jun 2016 £bn	31 Dec 2016 £bn
	12.1	11.2	11.7

IFRS unallocated surplus of UK with-profits funds			
Adjustments from IFRS basis to Solvency II:			
Value of shareholder transfers	(2.5)	(1.9)	(2.3)
Risk margin (net of transitional)	(0.6)	(0.7)	(0.7)
Other valuation differences	(0.4)	(0.4)	(0.3)
Estimated Solvency II Own Funds	**8.6**	**8.2**	**8.4**

Notes:

1 The UK shareholder capital position represents the consolidated capital position of the shareholder funds of The Prudential Assurance Company Ltd (PAC) and all its subsidiaries.

2 The UK with-profits capital position includes the PAC with-profits sub-fund, the Scottish Amicable Insurance Fund and the Defined Charge Participating Sub-Fund.

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II(c) Foreign currency source of key metrics

The table below shows the Group s key IFRS metrics analysis by contribution by currency group:

	Pre-tax operating profit % notes (2)(3)(4)	**Shareholders funds %** notes (2)(3)(4)
US dollar linked note(1)	**22%**	**21%**
Other Asia currencies	**18%**	**15%**
Total Asia	**40%**	**36%**
UK sterling notes (3)(4)	**14%**	**52%**
US dollar note (4)	**46%**	**12%**
Total	**100%**	**100%**

Notes

(1) US dollar linked comprise the Hong Kong and Vietnam operations where the currencies are pegged to the US dollar and the Malaysia and Singapore operations where the currencies are managed against a basket of currencies including the US dollar.

(2) Includes long-term, asset management business and other businesses.

(3) For operating profit and shareholders funds, UK sterling includes amounts in respect of UK insurance operations, M&G and central operations. Operating profit for central operations includes amounts for corporate expenditure for Group Head Office as well as Asia Regional Head Office which is incurred in HK dollars.

(4) For shareholders funds, the US dollar grouping includes US dollar denominated core structural borrowings. Sterling operating profits include all interest payable as sterling denominated, reflecting interest rate currency swaps in place.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorised.

Date: 10 August 2017	PRUDENTIAL PUBLIC LIMITED COMPANY
	By: /s/ MARK FITZPATRICK Name: Mark FitzPatrick Title: Chief Financial Officer