1. NATURE OF OPERATIONS

Prudential plc (the Company) together with its subsidiaries (collectively, the Group or Prudential) is an international financial services group with its principal operations in the United Kingdom, the United States and Asia. During 2004, the Group operated in the UK through its subsidiaries, primarily The Prudential Assurance Company Limited, Prudential Annuities Limited, Prudential Retirement Income Limited, M&G Group plc and Egg plc. In the US the Group's principal subsidiary is Jackson National Life Insurance Company. In Asia the Group's main operations are in Hong Kong, Japan, Malaysia, Singapore and Taiwan.

Long-term business products written in the UK and Asia are principally with-profits deposit administration, other conventional and unitised with-profits policies and non-participating pension annuities in the course of payment. Long-term business also includes linked business written in the UK and Asia. The principal products written by Jackson National Life in the US are interest sensitive deferred annuities and whole-life policies, variable annuities, guaranteed investment contracts, equity linked indexed deferred annuities and term life insurance.

2. BASIS OF PREPARATION

The consolidated financial statements are prepared in accordance with the provisions of Section 255A of, and Schedule 9A to, the Companies Act 1985 which cover the disclosures applicable to insurance companies and groups.

The consolidated financial statements are prepared in accordance with applicable accounting standards under UK Generally Accepted Accounting Practice (UK GAAP), including Financial Reporting Standards (FRS) and Statements of Standard Accounting Practice (SSAP) and also in accordance with the revised Statement of Recommended Practice, 'Accounting for Insurance Business', issued in November 2003 by the Association of British Insurers (the revised SORP). The results of US operations and certain Asian operations are prepared on the basis of US GAAP, with non-insurance balances adjusted where necessary to comply with UK GAAP.

FRS 17, 'Retirement benefits' was issued in November 2000. This standard specifies how costs of providing retirement benefits, in particular for defined benefit schemes, should be recognised and disclosed in the financial statements. Under FRS 17 none of the requirements need be recognised in the primary financial statements for the years ended 31 December 2004 and 2003. However, disclosure is required of the impact of FRS 17 on the opening and closing balance sheet positions, profit and loss account, and statement of total recognised gains and losses to illustrate the effect if the standard had been recognised in these primary financial statements, and details are disclosed in note 17.

The consolidated financial statements of the Group include the assets, liabilities and results of the Company and subsidiary undertakings in which Prudential has a controlling interest, using accounts drawn up to 31 December 2004. The results of subsidiaries are included in the financial statements from the date acquired to the effective date of disposal. All intercompany transactions are eliminated on consolidation except for investment management fees of £253m (£217m) charged by M&G and the Group's US and Asia fund management operations to long-term business funds.

The consolidated profit and loss account comprises a general business technical account (property and casualty insurance business), a long-term business technical account (life insurance, pension, disability and sickness insurance and annuity business), and a non-technical account. The insurance operations are presented by category of income and expenditure in each respective technical account. The balances (profits on insurance activities for the year) from the general and long-term business technical accounts are then included in the non-technical account and combined with the Group's non-insurance businesses (principally banking and fund management) to determine the consolidated profit for the financial year.

In accordance with FRS 1, 'Cash flow statements', the statement of cash flows reflects only the cash flows of the Group's non-insurance businesses included in the non-technical account and amounts transferred to shareholders' funds from the Group's long-term businesses.

The balance sheet of the Company is prepared in accordance with Section 226 of, and Schedule 4 to, the Companies Act 1985, which apply to companies generally. The Company has taken advantage of the exemption under Section 230 of the Companies Act 1985 from presenting its own profit and loss account.

3. SIGNIFICANT ACCOUNTING POLICIES

There have been no changes in the Group's accounting policies from those used in the 2003 statutory accounts with the exception of the implementation of UITF 38 as described in note 4.

Long-Term Business

The results are prepared in accordance with the modified statutory basis of reporting as set out in the revised Statement of Recommended Practice issued by the Association of British Insurers in November 2003.

Premiums and claims

Premium and annuity considerations for conventional with-profits policies and other protection-type life insurance policies are recognised when due. Premium and annuity considerations for linked policies, unitised with-profits policies and other investment-type policies are recognised when received or, in the case of unitised or unit-linked policies, when units are issued. Premiums exclude any taxes or duties assessed based on premiums.

Policy fees are charged to the linked, unitised with-profits and other investment-type policyholders' account balances for mortality, asset management and policy administration. These fees are recognised as revenue when charged against the policyholders' account balances.

Claims paid include maturities, annuities, surrenders and deaths. Maturity claims are recorded on the policy maturity date. Annuity claims are recorded when the annuity becomes due for payment. Surrenders are recorded when paid, and death claims are recorded when notified.

3. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Deferred acquisition costs

Costs of acquiring new business, principally commissions, marketing and advertising costs and certain other costs associated with policy issuance and underwriting that are not reimbursed by policy charges are specifically identified and capitalised as deferred acquisition costs (DAC), which are included as an asset in the balance sheet. The DAC asset is amortised against margins in future revenues on the related insurance policies, to the extent that the amounts are recoverable out of the margins. Recoverability of the unamortised DAC asset is assessed at the time of policy issue, and reviewed if profit margins have declined.

For with-profits business, the amortisation of the DAC asset is taken into account in determining the transfer from or to the fund for future appropriations. Movements on the DAC asset and amortisation for with-profits business have no direct impact on the profit attributable to shareholders.

For the business of Jackson National Life the determination of the expected emergence of margins, against which the amortisation profile of the DAC asset is established, is dependent on certain key assumptions. For single premium deferred annuity business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders. For variable annuity business, the key assumption is the expected long-term level of equity market returns which, for 2004 and 2003, was 8.4% per annum implemented using a mean reversion methodology. These returns affect the level of future expected profits through their effects on fee income and the required level of provision for guaranteed minimum death benefit claims.

Long-term business provision

UK Insurance Operations

Prudential's long-term business written in the UK comprises predominantly life insurance policies under which the policyholders are entitled to participate in the profits of the long-term business supporting these policies. This business is also written in parts of Asia. Such policies are called 'with-profits' policies. Prudential maintains with-profits funds within the Group's long-term business funds, which segregate the assets and liabilities and accumulate the profit and loss activity related to that with-profits business. The amounts accumulated in these with-profits funds are available to provide for future policyholder benefit provisions and for bonuses to be distributed to with-profits policyholders. The bonuses, both annual and final, reflect the right of the with-profits policyholders to participate in the financial performance of the with-profits funds. Shareholders' profits with respect to bonuses declared on with-profits business correspond to the shareholders' share of the cost of bonuses as declared by the Board of directors. The shareholders' share currently represents one-ninth of the cost of bonuses declared for with-profits policies.

Annual bonuses are declared and credited each year to all with-profits policies. The annual bonuses increase policy benefits and, once credited, become guaranteed. Annual bonuses are charged to the profit and loss account as a change in the long-term business provision in the year declared. Final bonuses are declared each year and accrued for all policies scheduled to mature and death benefits expected to be paid during the next financial year. Final bonuses are not guaranteed and are only paid on policies that result from claims through the death of the policyholder or maturity of the policy within the period of declaration or by concession on surrender. No policyholder benefit provisions are recorded for future annual or final bonus declarations.

The overwhelming majority of the liabilities for business in force of UK insurance operations are held by The Prudential Assurance Company Limited (PAC) and its subsidiaries Prudential Annuities Limited (PAL) and Prudential Retirement Income Limited (PRIL). The key features of the liabilities of these companies are as follows:

Conventional with-profits and other protection-type policies

The future policyholder benefit provisions on conventional with-profits and other protection-type policies are calculated using the net premium method. The net premium is calculated such that it would be sufficient at the outset of the policy to provide only for the discounted value of the original guaranteed death and maturity benefits on the chosen valuation assumptions. The provision is then calculated by subtracting the present value of future net premiums from the present value of future benefits (including vested bonuses) using a prudent discount rate.

Under the net premium valuation method, vested bonuses are included in the cash flows assessed but future allocations of bonuses are not included explicitly, although they are implicitly taken into account in the discount rate used, which is based on the return available on suitable investments. The detailed methodology for UK companies is included in regulations contained in the FSA rules. In particular, the returns available from equity and property assets are based on expected income and/or earnings and no allowance is made for potential future capital growth.

The assumptions to which the estimation of the long-term business provision for these contracts is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders. The net premium reserves are calculated using assumptions for interest, mortality, morbidity and expense, but without assumptions for withdrawals. These assumptions are determined as prudent best estimates at the date of valuation. Interest rates used in establishing policyholder benefit provisions for conventional with-profits policies in the consolidated financial statements range from 3.0% to 5.0% at 31 December 2004 and 31 December 2003. There have been no significant changes to other key assumptions.

Pension annuities

The interest rates used in establishing policyholder benefit provisions for pension annuities in the course of payment are adjusted each year and range from 1.5% to 5.0% at 31 December 2004 and 2.0% to 5.1% at 31 December 2003. Mortality rates used in establishing policyholder benefit provisions are based on published mortality tables adjusted to reflect actual experience. The only other noteworthy change to assumptions in 2004 was with respect to mortality, where the shape of the set of assumptions has been changed as part of the regular monitoring of mortality developments.

3. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Accumulating with-profits business

For accumulating with-profits business, the calculation of the long-term business provision is based on a gross premium bonus reserve valuation. In general terms, a gross premium valuation basis is one in which the premiums brought into account are the full amounts receivable under the contract. The method includes explicit estimates of premiums, expected claims, future regular bonuses, costs of maintaining contracts and future renewal expenses. Cash flows are discounted at the valuation rate of interest. The methodology for UK companies is included in the FSA rules. The discount rate is based on the expected return on the assets deemed to back the liabilities as prescribed by the FSA rules.

For PAC business the calculation is based on a valuation under which future reversionary bonuses are added to the guaranteed liabilities existing at the valuation date. The provision is then calculated as the present value of future policyholder benefits plus the present value of future expenses, without assumption for withdrawals.

An addition is made in respect of future premiums if this produces a higher provision. The assumptions to which the estimation of the long-term business provision is particularly sensitive are the assumed future reversionary bonuses, the interest rate used to discount the provision, the assumed future per policy expenses and the assumed future mortality experience of policyholders.

For PAC business, the provision has been taken as the lower of:

- the accumulated fund or the value at the bid price of the notional number of units allocated to policyholders, in both cases excluding final bonus; and
- the surrender or transfer value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date, or, if greater, the value of the guaranteed liabilities excluding final bonus calculated on a gross premium bonus reserve method.

For the purpose of calculating the liability using the bonus reserve method, the assumed interest rates range from 2.5% to 5.0% at 31 December 2004 and from 3.0% to 5.0% at 31 December 2003, while future reversionary bonuses are assumed to fall immediately from current levels to zero. There have been no significant changes of assumption for accumulating with-profits business.

Additional details for PAC, PAL and PRIL are given in the statutory accounts of those companies.

Jackson National Life

The future policyholder benefit provisions for Jackson National Life's conventional protection-type policies are determined using the net level premium method under US GAAP principles and assumptions as of the issue date as to mortality, interest, policy lapsation and expenses plus provisions for adverse deviations. Rates of interest used in establishing the policyholder benefit provisions range from 4.0% to 8.0%. Mortality assumptions range from 50% to 90% of the 1975-1980 Basic Select and Ultimate tables, depending on underwriting classification and policy duration. For investment-type products sold by Jackson National Life, the policyholder benefit provision included within technical provisions in the consolidated balance sheet is the policyholder account balance.

Asian Operations

The future policyholder benefit provisions for Asian businesses are determined in accordance with methods prescribed by local GAAP adjusted to comply, where necessary, with UK GAAP. For the Hong Kong business, which is a branch of PAC, and the Singapore and Malaysian operations the valuation principles and sensitivities to changes of assumptions of conventional with-profits and other protection-type policies are similar to those described above for equivalent products written by the UK operations. For Hong Kong business the interest rate has reduced to 3.4% at 31 December 2004 from 3.6% at 31 December 2003 for traditional business and to between 2.5% and 2.9% at 31 December 2004 from 3.25% at 31 December 2003 for accumulating with-profits assurances. For Singapore and Malaysia there have been no significant changes of assumption. Interest rates of 3.5% to 4.0% in Singapore and 4.0% in Malaysia at both 31 December 2004 and 31 December 2003 have been used in accordance with local regulations.

For Asian operations in countries where local GAAP is not well established and in which the business written is primarily non-participating and linked business, US GAAP is used as the most appropriate proxy to local GAAP. The future policyholder benefit provisions for non-linked business are determined using the net level premium method, with an allowance for surrenders, maintenance and claim expenses. Rates of interest used in establishing the policyholder benefit provisions vary by operation depending on the circumstances attaching to each block of business. As with the other Asian operations mentioned above, the assumptions to which the future policyholder benefit provisions are most sensitive are the interest rate used to discount the liabilities and the future mortality and morbidity experience of policyholders. In Taiwan, interest rates ranged from 1.4% to 7.0% at 31 December 2004 and from 1.5% to 6.5% at 31 December 2003. In Japan, they ranged from 0.9% to 1.3% at 31 December 2004 and from 0.9% to 1.6% at 31 December 2003.

Although the basis of valuation of Prudential's overseas operations is in accordance with the requirements of the Companies Act 1985 and ABI SORP, the valuation of policyholder benefit provisions for these businesses may differ from that determined on a UK modified statutory basis for UK operations with the same features.

Linked business

For all insurance operations, segregated accounts are established for policyholder business for which policyholder benefits are wholly or partly determined by reference to specific investments or to an investment-related index. The assets and liabilities of this linked business are reported as summary totals in the consolidated balance sheet.

3. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Fund for future appropriations

The fund for future appropriations (FFA) represents the excess of assets over policyholder liabilities for the Group's with-profits funds. 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, is transferred to (from) the FFA each year through a charge (credit) to the profit and loss account. The balance retained in the FFA represents cumulative retained earnings arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance retained in the FFA is determined after full provision for deferred tax on unrealised appreciation on investments. The FFA in respect of the Scottish Amicable Insurance Fund is wholly attributable, but not yet allocated, to policyholders of that fund. Details are shown in note 9.

Overseas subsidiaries

Results of overseas subsidiaries are determined initially using local GAAP bases of accounting with subsequent adjustments where necessary to comply with the Group's accounting policies.

In the case of Jackson National Life, US GAAP results are adjusted to comply with UK GAAP in respect of the valuation basis for fixed income securities and certain financial derivative instruments. Further details are shown in note 12.

General Insurance

General insurance business is accounted for on an annual accounting basis.

Revenue recognition

Premiums are recognised when risks are assumed. The proportion of premiums written relating to periods of risk beyond any year end is recorded as an unearned premium provision and subsequently recognised in earnings proportional to the period of the risk. Premiums are presented gross of commission and exclude any taxes or duties assessed based on premium.

Claims

Claims incurred include settlement and handling costs of paid and outstanding claims arising from events occurring in the year and adjustments to prior years' claims provisions. Outstanding claims include claims incurred up to, but not paid at, the end of the accounting period, whether or not reported.

Investment Returns

Investment returns comprise investment income, realised gains and losses and changes in unrealised gains and losses, except for changes in unrealised gains and losses on debt securities held by Jackson National Life. Subject to provisions for permanent diminutions in value, debt securities held by Jackson National Life are carried at amortised cost.

Realised investment gains and losses represent the difference between the net sale proceeds and the cost of acquisition. Unrealised investment gains and losses represent the difference between the carrying value at the previous year-end (or purchase value during the year) and the carrying value at the current year-end.

Investment returns in respect of long-term business, including those on assets matching solvency capital, are included in the long-term business technical account. Other investment returns are included in the non-technical account.

Investment returns on assets covering general business liabilities are allocated from the non-technical account to the general business technical account. Investment returns are also allocated between the long-term business technical account and the non-technical account for the difference between the actual investment rate of return of the long-term business technical account and the long-term rate of return on the assets backing shareholder financed long-term business (primarily Jackson National Life and certain Asian operations). Further details are provided in note 5.

Reinsurance

In the normal course of business, the Group seeks to reduce loss exposure arising primarily from catastrophes or other significant adverse events by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers. An asset or liability is recorded in the consolidated balance sheet representing premiums due to or payments due from reinsurers, and the share of losses recoverable from reinsurers.

Tax

The Group's UK subsidiaries each file separate tax returns. Jackson National Life and other foreign subsidiaries, where permitted, file consolidated income tax returns. In accordance with UK tax legislation, where one domestic UK company is a 75% owned subsidiary of another UK company or both are 75% owned subsidiaries of a common parent, the companies are considered to be within the same UK tax group. For companies within the same tax group, trading profits and losses arising in the same accounting period may be offset for purposes of determining current and deferred taxes.

Current tax expense is charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year. To the extent that losses of an individual UK company are not offset in any one year, they can be carried back for one year or carried forward indefinitely to be offset against profits arising from the same company.

Deferred tax assets and liabilities are recognised in accordance with the provisions of FRS 19. The Company has chosen not to apply the option available of recognising such assets and liabilities on a discounted basis to reflect the time value of money. Except as set out in FRS 19, deferred tax is recognised in respect of all timing differences that have originated but not reversed by the balance sheet date.

3. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Tax continued

Deferred tax on changes in the fair value of investments is recognised in the profit and loss account. The deferred tax liability in respect of revaluation of investments is reflected in shareholders' funds and the fund for future appropriations. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

The tax charge for long-term business included in the long-term business technical account includes tax expense on with-profits funds attributable to both the policyholders and the shareholders. Different tax rules apply under UK law depending upon whether the business is life insurance or pension business. Tax on the life insurance business is based on investment returns less expenses attributable to that business. Tax on the pension business is based on the shareholders' profits or losses attributable to that business. The shareholders' portion of the long-term business is taxed at the shareholders' rate with the remaining portion taxed at rates applicable to the policyholders.

The balance on the long-term business technical account is net of the total tax attributable to the long-term business. In order to present the profit on long-term insurance activities in the non-technical account on a pre-tax basis, a tax credit attributable to the shareholders' portion of the tax provision for long-term business, calculated at the effective tax rate (where appropriate on a long-term basis) of the underlying business, is added. This shareholder tax add-back is then included in the tax expense on the profit on ordinary activities within the non-technical account. Further details are provided in note 20.

Stock-Based Compensation

The Group offers share award and option plans for certain key employees and a Save As You Earn plan (SAYE plan) for all UK and certain overseas employees. The arrangements for distribution to employees of shares held in trust relating to share award plans and for entitlement to dividends depend upon the particular terms of each plan. Shares held in trust relating to these plans are conditionally gifted to employees. Compensation costs for non-SAYE plans are recorded over the periods during which share awards or options are earned. Compensation costs are based on the quoted market prices of the shares at the grant date less any amounts paid or payable by employees in respect of the awards. In addition, shares are issued to a qualifying share ownership trust with the excess of the market price subscribed at the date of transfer by the trust over nominal value recorded by the Company in its share premium account.

In December 2003, Urgent Issues Task Force Abstract 38 'Accounting for Employee Share Ownership Trusts' (UITF 38) was issued. The main effect of UITF 38 is that the Company must present the cost of acquiring the shares held in such trusts as a deduction in determining shareholders' funds. The Company has adopted the provisions of UITF 38 in its 2004 results. Further details are provided in note 4.

Pension Costs

These financial statements have been prepared in accordance with the provisions of SSAP 24, 'Pension costs'. Disclosures of the movements in the financial position of the Company's defined benefit schemes, applying the methodology prescribed by FRS 17, are shown in note 17. Contributions to the Group's defined benefit plans are calculated and expensed on a basis that spreads the costs over the service lives of participants. Contributions in respect of defined contribution plans are accrued by the Group when incurred.

Land and Buildings

Investments in tenant and Group occupied leasehold and freehold (directly owned) properties are carried at estimated fair value, with changes in estimated fair value included in investment returns. Properties are valued annually either by the Group's qualified surveyors or professional external valuers using The Royal Institution of Chartered Surveyors (RICS) guidelines. The RICS guidelines apply separate assumptions to the value of the land, buildings and tenancy associated with each property. Each property is externally valued at least once every three years. The cost of additions and renovations is capitalised and considered when estimating fair value.

In accordance with SSAP 19, 'Investment properties', no depreciation is provided on investment properties (other than Group occupied) as the directors consider that these properties are held for investment purposes.

Investments in Participating Interests

A participating interest is a beneficial equity investment where the Group exercises influence over the investee's operating and financial policies. A participating interest where the Group exercises significant influence over the investee, generally through ownership of 20% or more of the entity's voting rights, is considered to be an investment in associate. The Group's investments in associates are recorded at the Group's share of net assets. The carrying value of investments in associates is adjusted each year for the Group's share of the entities' profit or loss.

The Group's investments in joint ventures are also recorded at the Group's share of net assets. Other participating interests, where significant influence is not exercised, are carried as investments on the consolidated balance sheet at fair value.

Other Financial Investments

Other financial investments include equity securities, debt and other fixed income securities, mortgages and other loans, loans to policyholders (excluding unpaid interest) and deposits with credit institutions.

3. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Equity securities and debt and other fixed income securities

Equity securities are carried at fair value. Debt and other fixed income securities are carried at fair value, except for those held by Jackson National Life, which, subject to provision for permanent diminutions in value, are carried at amortised cost. Fair value is based on quoted market prices for listed securities, and on quotations provided by external fund managers, brokers, independent pricing services or values as determined by the directors for unlisted securities. Changes in fair value are recognised in investment returns during the year of the change. Debt and other fixed income securities held by Jackson National Life are carried at amortised cost as permitted by paragraph 24 of Schedule 9A to the Companies Act 1985. The amortised cost basis of valuation is appropriate under the provisions of the ABI SORP for Jackson National Life's redeemable fixed income securities as they are held as part of a portfolio of such securities intended to be held to maturity. Further details of the valuation basis for fixed income securities of Jackson National Life are explained in note 12.

Mortgages and other loans

Loans collateralised by mortgages and other unsecured loans are carried at unpaid principal balances, net of unamortised discounts and premiums and an allowance for loan losses, except for loans held by UK insurance operations which are carried at fair value. The allowance for loan losses is maintained at a level considered adequate to absorb losses inherent in the mortgage loan portfolio.

Loans to policyholders

Loans to policyholders are carried at unpaid principal balances and are fully collateralised by the cash value of policies.

Deposits with credit institutions

Deposits with credit institutions comprise items, the withdrawal of which are subject to time constraints, and are carried at fair value. Changes in fair value are included in investment returns for the year.

Shares in Subsidiary Undertakings

Shares in subsidiary undertakings in the balance sheet of the Company are shown at the lower of cost and estimated realisable value.

Derivatives

Derivative financial instruments are used to reduce or manage investment, interest rate and currency exposures, to facilitate efficient portfolio management and for investment purposes. The Group's policy is that amounts at risk through derivative transactions are covered by cash or by corresponding assets. Derivative financial instruments are used to facilitate efficient portfolio management and for investment purposes. With the exception of derivatives held by Jackson National Life, these instruments are carried at fair value with changes in fair value included in investment returns. For Jackson National Life, the accounting for derivative financial instruments is explained in note 12.

As part of the efficient portfolio management of the Life Fund of The Prudential Assurance Company Limited, the fund may, from time to time, invest in cash settled forward contracts over Prudential plc shares. This is in order to avoid a mismatch of the Life Fund's investment portfolio with the investment benchmarks set for its equity based investment funds. The contracts will form part of the long-term investments of the Life Fund. These contracts are subject to a number of limitations for legal and regulatory reasons.

Securities Lending

The Group is party to various securities lending agreements under which securities are loaned to third parties on a short-term basis. The loaned securities are not removed from the Group's consolidated balance sheet; rather, they are retained within the appropriate investment classification. The Group's policy is that collateral in excess of 100% of the fair value of securities loaned is required from all securities borrowers and typically consists of cash, debt securities, equity securities or letters of credit.

In cases where the Group takes possession of the collateral under its securities lending programme, the collateral is included in other financial investments in the consolidated balance sheet with a corresponding liability being recorded to recognise the obligation to return such collateral. To further minimise credit risk, the financial condition of counterparties is monitored on a regular basis.

Linked Business Funds

Certain long-term business policies are linked to specific portfolios of assets or to an investment-related index. Such policies provide benefits to policyholders that are wholly or partly determined by reference to the value of or income from specific investments or by reference to fluctuations in the value of an index of investments. The assets supporting the linked policies are maintained in segregated accounts in conformity with applicable laws and regulations. The segregated assets are reported at fair value within assets held to cover linked liabilities on the consolidated balance sheet. The technical provisions for linked liabilities on the consolidated balance sheet are determined based on the fair value of the underlying assets supporting the policies.

Tangible Assets

Tangible assets, principally computer equipment, software development expenditure, and furniture and fixtures, are capitalised and depreciated on a straight-line basis over their estimated useful lives, generally three to ten years. Leasehold improvements are depreciated over the life of the lease. Assets held under finance leases are capitalised at their fair value.

3. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Banking Business Assets and Liabilities

Banking business assets consist primarily of certificates of deposit and short-term deposits with credit institutions carried at fair value and mortgage loans carried at recoverable amount, being outstanding principal balances, net of allowances for loan losses. Loan provisions are recorded for the overall loan portfolio to cover bad debts which have not been separately identified but which are known from experience to be present in the portfolio. For loans in default, specific loan provisions are recorded. General provisions are raised in respect of losses, which although not specifically identified, are known from experience to be present in any such portfolios. The level of general provision is determined by the application of a number of basis points to the aspects of the portfolio which are not currently identified as delinquent but which experience suggests contains lending which will ultimately lead to losses. The number of basis points applied to the portfolios are regularly assessed against recent experience and adjusted if appropriate. Changes in loan provisions during the year are included in the consolidated profit and loss account.

Liabilities relating to the Group's banking business consist primarily of customer short-term or demand deposits, including interest accrued on the deposits.

Further details of UK banking business assets and liabilities are contained in note 11.

Business Acquisitions and Disposals

Business acquisitions are accounted for by applying the purchase method of accounting, which adjusts the net assets of the acquired company to fair value at the date of purchase. The difference between the fair value of the net assets of the acquired company and the fair value of the consideration given represents goodwill. Revenues and expenses of acquired entities are included in the consolidated profit and loss account from the date of acquisition in the year acquired. Revenues and expenses of entities sold during the period are included in the consolidated profit and loss account up to the date of disposal. The profit or loss on disposal is calculated as the difference between sale proceeds net of expenses less net assets of the entity at the date of disposal. Gross premiums of acquired or sold insurance entities are separately presented in the consolidated profit and loss account.

With effect from 1 January 1998, goodwill arising from acquisitions is reflected as an asset on the consolidated balance sheet and is amortised through the consolidated profit and loss account on a straight-line basis over its estimated useful life, not exceeding 20 years. Prior to 1 January 1998, goodwill relating to acquisitions was charged directly to shareholders' funds. As permitted under the transitional arrangements of FRS 10, 'Goodwill and intangible assets', amounts previously charged to shareholders' funds have not been reinstated as assets. Upon disposal of a business acquired prior to 1 January 1998 to which goodwill relates, the original goodwill balance is charged to the consolidated profit and loss account in determining the gain or loss on the sale.

For life insurance company acquisitions, the adjusted net assets include an identifiable intangible asset recorded for the present value of in-force business which represents the profits that are expected to emerge from the acquired insurance business. The present value of in-force business is calculated using best estimate actuarial assumptions for interest, mortality, persistency and expenses and is amortised over the anticipated lives of the related contracts in the portfolio.

Shareholders' Dividends

Shareholders' dividends are accrued in the period to which they relate regardless of when they are declared. Where scrip dividends are issued, the value of such shares, measured as the amount of the cash dividend alternative, is credited to reserves and then the amount in excess of the nominal value of the shares issued is transferred from the share premium account to retained profit.

Share Premium

The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of the shares issued is credited to the share premium account.

Foreign Currency Translation

The profit and loss accounts of foreign subsidiaries are translated at average exchange rates for the year. Assets and liabilities of foreign subsidiaries are translated at year-end exchange rates. Foreign currency borrowings that have been used to finance or provide a hedge against Group equity investments in overseas subsidiaries are translated at year-end exchange rates. The impact of these currency translations is recorded as a component of shareholders' funds within the statement of total recognised gains and losses.

Other assets and liabilities denominated in foreign currencies are also converted at year-end exchange rates with the related foreign currency exchange gains or losses reflected in the profit and loss account for the year.

4. IMPLEMENTATION OF UITF ABSTRACT 38 'ACCOUNTING FOR ESOP TRUSTS'

The Company has implemented UITF Abstract 38 'Accounting for ESOP Trusts' in preparing its 2004 results which requires the Company to present the cost of acquiring shares held in trusts for employee incentive plans as a deduction in determining shareholders' funds. The effect of the change in policy is to reduce the Group's shareholders' funds at 1 January 2004 from the previously published 31 December 2003 level by £38m. Comparative balance sheet amounts have been restated accordingly. The impact on the profit and loss account is immaterial.

5. SUPPLEMENTAL EARNINGS INFORMATION

The Group uses operating profit based on long-term investment returns before amortisation of goodwill as a supplemental measure of its results. For the purposes of measuring operating profit, investment returns on shareholder financed business are based on expected long-term rates of return. The expected long-term rates of return are intended to reflect historical real rates of return and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The significant operations that require adjustment for the difference between actual and long-term investment returns are Jackson National Life and certain businesses in Asia.

For the Group's continuing operations with investment portfolios that are both attributable to shareholders and subject to short-term volatility, and the UK general business that was sold in 2002, a comparison of actual and long-term gains is as follows:

	1993 to 2004 £m	**2004 £m**	1993 to 2003 £m	2003 £m	1993 to 2002 £m	2002 £m	1993 to 2001 £m
Actual gains attributable to shareholders:							
Jackson National Life	**(429)**	**88**	(517)	6	(523)	(342)	(181)
Other operations	**486**	**46**	440	15	425	66	359
	57	**134**	(77)	21	(98)	(276)	178
Long-term gains credited to operating results:							
Jackson National Life	**(46)**	**(71)**	25	(87)	112	(84)	196
Other operations	**274**	**(15)**	289	21	268	8	260
	228	**(86)**	314	(66)	380	(76)	456
Excess (shortfall) of actual gains over long-term gains	**(171)**	**220**	(391)	87	(478)	(200)	(278)

For the purposes of determining the long-term investment returns of Jackson National Life, from 2001 realised gains and losses arising on debt securities (including losses arising on the recognition of permanent diminutions in value) have been averaged over five years for inclusion in operating profit. For equity-related investments of Jackson National Life, a long-term rate of return of 8.0% has been assumed and this rate has been applied to the monthly average carrying value of such investments after excluding the estimated effect of short-term market movements.

In years prior to 2001, long-term investment returns for Jackson National Life included within UK basis operating profit were estimated as the aggregate of investment income and averaged realised gains and losses for both debt securities and other types of security. Comparatives for the aggregate long-term gains credited to operating results for the years 1993 to 2000 in the table shown above have not been restated for the refinement in policy, as the effect is not material.

From 2002, the other principal component of actual gains attributable to shareholders has been the revaluation gains of fixed income securities of certain Asian operations. For 2001 and earlier years the principal other component that required calculation of the expected long-term rate of return was UK equity securities that were held as portfolio investments backing UK general business liabilities and related solvency capital. This business was disposed of in 2002. For these investments the long-term rate of return applied in 2001 was 7.5%. The long-term dividend yield was assumed to be 2.6%.

The overwhelming majority of long-term gains and losses, and the difference between actual and long-term gains, arises from the accounting treatment of averaging realised gains and losses of Jackson National Life's fixed income securities over a five-year period within operating results. The only significant part of the investment portfolio for shareholder backed business where an assumed rate has been applied in the calculation of long-term gains to be included in operating profits is the aforementioned 8.0% for equity-related investments of Jackson National Life. For this part of the portfolio, a 1% change would alter operating results by approximately £4m.

In addition to the adjustments made for investment returns, as described above, operating profit excludes amortisation of goodwill and gains on business disposals and similar items.

In accordance with FRS 3, the presentation of additional supplementary earnings per share information is permitted provided the earnings basis used is applied consistently over time and is reconciled to consolidated profit for the financial year. In determining operating profit, the Group has used the expected long-term investment return and excluded amortisation of goodwill and exceptional items as the directors believe that such presentation better reflects the Group's underlying performance on a statutory basis of measurement.

5. SUPPLEMENTAL EARNINGS INFORMATION CONTINUED

The Group's supplemental measure of its results and reconciliation of operating profit based on long-term investment returns before amortisation of goodwill to profit on ordinary activities, including the related basic earnings per share amounts, are as follows:

	Before tax (note 8) £m	Tax (note 20) £m	Minority interests £m	Net £m	Basic earnings per share Pence
2004					
Operating profit based on long-term investment returns before amortisation of goodwill	**583**	**(177)**	**2**	**408**	**19.2p**
Amortisation of goodwill	**(97)**			**(97)**	**(4.6)p**
Short-term fluctuations in investment returns:					
Jackson National Life	**159**	**(56)**		**103**	**4.8p**
Other†	**70**	**(12)**	**(9)**	**49**	**2.3p**
Profit or loss on the sale or termination of discontinued operations:					
Profit on business disposals	**48**	**(19)**		**29**	**1.4p**
Egg France closure cost	**(113)**	**32**	**17**	**(64)**	**(3.0)p**
Profit on ordinary activities	**650**	**(232)**	**10**	**428**	**20.1p**
2003 (restated*)					
Operating profit based on long-term investment returns before amortisation of goodwill	357	(106)	6	257	12.4p
Amortisation of goodwill	(98)			(98)	(4.7)p
Short-term fluctuations in investment returns:					
Jackson National Life	93	(32)		61	2.9p
Other†	(2)	(6)	(4)	(12)	(0.6)p
Profit on ordinary activities	350	(144)	2	208	10.0p

* The 2003 earnings per share figures have been restated to take account of the Rights Issue in 2004.

† The adjustment from post-tax long-term investment returns to post-tax actual investment returns includes investment returns that are attributable to external equity investors in two investment funds managed by PPM America. These two funds are consolidated as quasi-subsidiaries but, except to the extent of Group participation in the funds, they have no net impact on pre-tax or post-tax operating profit. Total profit, before and after tax, incorporating the adjustment from long term to actual investment returns, includes gains of £9m (£4m) attributable to the minority interests in these funds.

A reconciliation of the weighted average number of ordinary shares used for calculating basic and diluted earnings per share is set out below. The numbers for 2003 have been restated to take account of the Rights Issue in 2004.

	2004 Millions	2003 Millions
Weighted average shares for basic earnings per share	**2,129**	2,076
Shares under option at end of year (note 28)	**13**	16
Number of shares that would have been issued at fair value on assumed option exercise	**(10)**	(14)
Weighted average shares for diluted earnings per share	**2,132**	2,078

6. SEGMENTAL INFORMATION – ANALYSIS OF LONG-TERM BUSINESS GROSS PREMIUMS WRITTEN

	2004 £m	2003 £m
UK and Europe Insurance Operations	**9,186**	7,264
Jackson National Life	**4,717**	4,369
Asian Operations	**2,452**	2,148
Total	**16,355**	13,781

The analysis of gross premiums written is based on the territory of the operating unit assuming the risk. A similar analysis by territory of risk would not be materially different.

7. SEGMENTAL INFORMATION – INSURANCE AND INVESTMENT PRODUCTS NEW BUSINESS

Insurance Products and Investment Products

	Insurance Products Gross Premiums		Investment Products Gross Inflows		Total	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
UK and Europe Operations	**6,538**	4,128	**5,845**	3,797	**12,383**	7,925
US Operations	**4,420**	4,066	**418**	159	**4,838**	4,225
Asian Operations	**1,172**	989	**18,845**	18,157	**20,017**	19,146
Group total	**12,130**	9,183	**25,108**	22,113	**37,238**	31,296

7. SEGMENTAL INFORMATION – INSURANCE AND INVESTMENT PRODUCTS NEW BUSINESS CONTINUED

Insurance Products – New Business Premiums

	Single		Regular		Annual Premium Equivalents	
	2004 £m	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
UK and Europe Insurance Operations						
Direct to customer						
Individual annuities	**630**	657	**–**	–	**63**	66
Individual pensions and life	**19**	22	**10**	12	**12**	14
Department of Work and Pensions rebate business	**265**	280	**–**	–	**27**	28
Total	**914**	959	**10**	12	**102**	108
Business to Business						
Corporate pensions	**153**	168	**137**	127	**152**	144
Individual annuities	**229**	223	**–**	–	**23**	22
Bulk annuities	**474**	287	**–**	–	**47**	29
Total	**856**	678	**137**	127	**222**	195
Intermediated distribution						
Life	**1,001**	818	**5**	22	**105**	104
Individual annuities	**1,180**	828	**–**	–	**118**	83
Individual and corporate pensions	**189**	120	**25**	29	**44**	41
Department of Work and Pensions rebate business	**89**	103	**–**	–	**9**	10
Total	**2,459**	1,869	**30**	51	**276**	238
Partnerships						
Life	**790**	293	**2**	–	**81**	29
Individual and bulk annuities	**1,249**	52	**–**	–	**125**	5
Total	**2,039**	345	**2**	–	**206**	34
Europe						
Life	**89**	87	**2**	–	**11**	9
Total UK and Europe Insurance Operations	**6,357**	3,938	**181**	190	**817**	584
US Operations						
Fixed annuities	**1,130**	1,375	**–**	–	**113**	138
Equity linked indexed annuities	**429**	255	**–**	–	**43**	25
Variable annuities	**1,981**	1,937	**–**	–	**198**	194
Life	**16**	–	**12**	13	**14**	13
Guaranteed Investment Contracts	**180**	183	**–**	–	**18**	18
GIC – Medium Term Notes	**672**	303	**–**	–	**67**	30
Total	**4,408**	4,053	**12**	13	**453**	418
Asian Operations						
China	**9**	7	**16**	11	**17**	12
Hong Kong	**255**	189	**78**	83	**103**	102
India (Group's 26% interest)	**5**	4	**33**	16	**33**	16
Indonesia	**38**	27	**28**	31	**32**	34
Japan	**17**	9	**7**	35	**9**	36
Korea	**36**	19	**60**	30	**64**	32
Malaysia	**7**	11	**61**	59	**62**	60
Singapore	**199**	181	**47**	57	**67**	75
Taiwan	**88**	28	**143**	132	**151**	135
Other	**8**	7	**37**	53	**38**	53
Total	**662**	482	**510**	507	**576**	555
Group total	**11,427**	8,473	**703**	710	**1,846**	1,557

Annual Premium Equivalents are calculated as the aggregate of regular new business premiums and one tenth of single new business premiums.

7. SEGMENTAL INFORMATION – INSURANCE AND INVESTMENT PRODUCTS NEW BUSINESS CONTINUED

Investment Products – Funds Under Management (FUM)

	FUM 1 Jan 2004 £m	Gross inflows £m	Redemptions £m	Market and other movements £m	FUM 31 Dec 2004 £m
UK and Europe Operations	**24,192**	**5,845**	**(3,841)**	**2,509**	**28,705**
US Operations	**148**	**418**	**(31)**	**15**	**550**
Asian Operations	**6,596**	**18,845**	**(17,647)**	**38**	**7,832**
Total	**30,936**	**25,108**	**(21,519)**	**2,562**	**37,087**

8. SEGMENTAL INFORMATION – PROFIT ON ORDINARY ACTIVITIES BEFORE TAX

	Balance on general business technical account		Balance on long-term business technical account before tax		Other activities		Total	
	2004 £m	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Operating profit before amortisation of goodwill								
UK and Europe Insurance Operations	**0**	0	**305**	256			**305**	256
M&G					**136**	83	**136**	83
Egg – continuing operations (note 11)					**43**	55	**43**	55
– discontinued operations (note 11)					**(37)**	(89)	**(37)**	(89)
Total UK and Europe Operations	**0**	0	**305**	256	**142**	49	**447**	305
US Operations:								
Jackson National Life – continuing operations (note 12)			**196**	143			**196**	143
– discontinued operations (note 34)			**17**	22			**17**	22
Broker-dealer and fund management (note 12)					**(14)**	(3)	**(14)**	(3)
Total US Operations			**213**	165	**(14)**	(3)	**199**	162
Asian Operations (net of development expenses of £15m (£27m))			**111**	58	**19**	13	**130**	71
Other Income and Expenditure:								
Investment income†					**56**	60	**56**	60
Unrealised gains (losses) on investments					**8**	(10)	**8**	(10)
Allocations from technical accounts					**209**	70	**209**	70
Short-term fluctuations in investment returns					**(229)**	(91)	**(229)**	(91)
Investment return and other income					**44**	29	**44**	29
Interest payable on core structural borrowings (note 16)					**(154)**	(143)	**(154)**	(143)
Corporate expenditure:								
Group Head Office					**(54)**	(43)	**(54)**	(43)
Asia Regional Head Office					**(29)**	(24)	**(29)**	(24)
Total					**(193)**	(181)	**(193)**	(181)
Operating profit before amortisation of goodwill			**629**	479	**(46)**	(122)	**583**	357
Analysed as:								
Continuing operations			**612**	457	**(9)**	(33)	**603**	424
Discontinued operations (notes 11 and 34)			**17**	22	**(37)**	(89)	**(20)**	(67)
Items excluded from operating profit before amortisation of goodwill:								
Amortisation of goodwill (note 21)					**(97)**	(98)	**(97)**	(98)
Short-term fluctuations in investment returns (note 5)					**229**	91	**229**	91
Profit or loss on the sale or termination of discontinued operations:								
Profit on business disposals (note 34)					**48**	–	**48**	–
Egg France closure cost (note 11)					**(113)**	–	**(113)**	–
Total					**67**	(7)	**67**	(7)
Statutory basis profit on ordinary activities before tax	**0**	0	**629**	479	**21**	(129)	**650**	350

† Investment income is shown after deducting interest payable on non-core borrowings, as shown in note 16.

9. SEGMENTAL INFORMATION – NET ASSETS

A segmental analysis of the fund for future appropriations and the technical provisions net of reinsurers' share is set out below which, although liabilities, provides a more useful indication of the assets supporting the business:

Fund for future appropriations and net technical provisions	2004 £m	Restated 2003 £m
Fund for future appropriations:		
Scottish Amicable Insurance Fund of Prudential Assurance Company (PAC)		
(closed to new business and wholly attributable but not allocated to policyholders)†	**1,836**	1,404
Other funds*	**14,850**	11,253
	16,686	12,657
Technical provisions (net of reinsurers' share)	**128,083**	120,449
Total*	**144,769**	133,106
Comprising:		
UK and Europe Operations*	**111,846**	102,565
Jackson National Life	**24,682**	23,854
Asian Operations	**8,241**	6,687
Total*	**144,769**	133,106

* The 2003 figures for these lines have been restated (see note 4).

† The Scottish Amicable Insurance Fund (SAIF) is a separate sub-fund within the PAC long-term business fund. This sub-fund contains all the with-profits business and all other pension business that was transferred from the Scottish Amicable Life Assurance Society to PAC in 1997. No new business is written in the sub-fund. The SAIF sub-fund is managed to ensure that all the invested assets of SAIF are distributed to SAIF policyholders over the lifetime of the SAIF policies. With the exception of certain amounts in respect of unitised with-profits life business, all future earnings arising in SAIF are retained for existing SAIF with-profits policyholders. Any excess (deficiency) of revenue over expense within SAIF during a period is offset by a transfer to (from) the SAIF fund for future appropriations. Shareholders have no interest in the profits of SAIF, although they are entitled to the investment management fees paid on this business. Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency. With the exception of certain guaranteed annuity products (as described in note 33), SAIF with-profits policies do not guarantee minimum rates of return to policyholders.

10. SEGMENTAL INFORMATION – SHAREHOLDERS' FUNDS

Analysis of shareholders' capital and reserves	Net assets before core shareholder borrowings 2004 £m	Core structural borrowings of shareholder financed operations (note 32) 2004 £m	Shareholders' funds 2004 £m	Restated net assets before core shareholder borrowings 2003 £m	Core structural borrowings of shareholder financed operations (note 32) 2003 £m	Restated shareholders' funds 2003 £m
UK and Europe Operations:						
Long-term business operations	**889**		**889**	612		612
M&G	**312**		**312**	336		336
Egg (note 11)†	**269**		**269**	348		348
	1,470		**1,470**	1,296		1,296
US Operations†:						
Jackson National Life (note 12)	**2,428**	**(130)**	**2,298**	2,398	(140)	2,258
Broker-dealer and fund management (note 12)	**64**		**64**	71		71
	2,492	**(130)**	**2,362**	2,469	(140)	2,329
Asian Operations	**819**		**819**	627		627
Other Operations:						
Goodwill†	**1,352**		**1,352**	1,445		1,445
Holding company net borrowings	**1,561**	**(2,667)**	**(1,106)**	432	(2,427)	(1,995)
Other net liabilities*	**(616)**		**(616)**	(462)		(462)
	2,297	**(2,667)**	**(370)**	1,415	(2,427)	(1,012)
Total*	**7,078**	**(2,797)**	**4,281**	5,807	(2,567)	3,240

* The 2003 figures for these lines have been restated (see note 4).

† Total goodwill comprises amounts included in:

	2004 £m	2003 £m
Other Operations relating to M&G and acquired Asian businesses	**1,352**	1,445
US Operations	**15**	53
Egg	**–**	6
Total (note 21)	**1,367**	1,504

11. SEGMENTAL INFORMATION – UK OPERATIONS

(i) General Business

	Gross premiums written		Underwriting result		Investment return		Operating profit	
	2004 £m	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
UK commercial business (in run-off)	**–**	–	**(6)**	(7)	**6**	7	**0**	0

The Group sold its UK home and motor insurance business in 2002 and, as part of the sale arrangements, the insurance liabilities of this business at the end of 2001 were fully reinsured. This business is now in run-off, as is the Group's UK commercial business that was closed to new business in 1992.

(ii) Egg

	Operating result	
	2004 £m	Restated 2003 £m
Interest receivable from:		
Loans and advances to customers	**553**	461
Debt securities	**180**	177
Other	**170**	184
	903	822
Interest payable on:		
Customer accounts	**(237)**	(236)
Other	**(379)**	(323)
	(616)	(559)
Net interest income	**287**	263
Other operating income	**210**	157
Operating income	**497**	420
Administrative expenses	**(232)**	(214)
Provision for bad and doubtful debts	**(182)**	(127)
Other expenses	**(40)**	(24)
Operating profit from continuing operations	**43**	55

In July 2004, Egg announced that it intended to take the necessary steps to withdraw from the French market at an expected cost of £113m. After taking into account tax relief of £32m, the effect on minority interests was £17m. This business, which has been treated as discontinued operations in these financial statements, incurred losses up to the date of the announcement of £37m (£89m).

	Balance sheet	
	2004 £m	Restated 2003 £m
Assets		
Loans and advances to banks	**616**	330
Loans and advances to customers	**7,642**	6,718
Debt securities	**3,120**	4,157
Other banking business assets	**617**	449
Total banking business assets	**11,995**	11,654
Other assets	**33**	41
Total	**12,028**	11,695
Liabilities		
Customer accounts	**6,607**	6,452
Debt securities issued (note 32)	**1,807**	1,423
Securities sold under agreements to repurchase (note 32)	**131**	829
Deposits by banks	**2,352**	1,610
Other banking business liabilities	**320**	473
Total banking business liabilities	**11,217**	10,787
Debenture loans (note 32)	**451**	451
Other liabilities including tax	**22**	23
	11,690	11,261
Shareholders' funds:		
Group share	**269**	348
Minority interests	**69**	86
Total	**12,028**	11,695

12. US OPERATIONS – ADDITIONAL DETAIL ON BASIS OF PRESENTATION OF RESULTS

The results of US Operations, mainly Jackson National Life (JNL), are consolidated into the Group accounts based on US Generally Accepted Accounting Principles (US GAAP). However, certain adjustments are made in the Group's consolidated financial statements to the US GAAP results reported in Jackson National Life's own financial statements in order to comply with UK GAAP, with the Group's accounting policies, and to reflect appropriately the US Operations segmental result, as set out below:

Reconciliation from JNL 2004 US GAAP basis result to UK GAAP result for US Operations	US GAAP per JNL financial statements	Reverse FAS 115 and FAS 133 effects (notes (i) and (ii)) and adjust for minority interests (note (iii))	US GAAP adjusted for minority interests and reversal of FAS 115 and FAS 133 effects	Other US subsidiaries	Long-term investment returns and other minor adjustments (note (iv))	US Operations segmental result for UK Modified Statutory Basis GAAP purposes (note (v))	
	US$m	US$m	US$m	US$m	US$m	US$m	£m
Profit and loss account							
Operating profit:							
Jackson National Life	788	(245)	543		(184)	359	196
Broker-dealer and fund management				11	(37)	(26)	(14)
Realised investment gains (losses), net of related change to amortisation of acquisition costs (note (ii)) (US GAAP as published also includes the change in the fair value of hedging instruments)	143	(65)	78		(78)		
Short-term fluctuations in investment returns					291	291	159
Gain on sale of Jackson Federal Bank	66		66		10	76	41
Income from discontinued operations	32		32			32	17
Amortisation of goodwill				(2)	(4)	(6)	(3)
Profit before tax before minority interests	1,029	(310)	719	9	(2)	726	396
Minority interests (note (iii))	(49)	49	–				
Profit before tax after minority interests	980	(261)	719	9	(2)	726	396
Tax (charge) credit:							
on operating profit	(276)	86	(190)	(4)	77	(117)	(64)
on realised investment gains and losses	(33)	6	(27)		27		
on short-term fluctuations in investment returns					(103)	(103)	(56)
on disposals	(30)		(30)			(30)	(16)
on income from discontinued operations	(11)		(11)			(11)	(6)
Total tax charge	(350)	92	(258)	(4)	1	(261)	(142)
Net income	630	(169)	461	5	(1)	465	254
Movement in shareholders' funds							
Net income (as shown above)	630	(169)	461	5	(1)	465	
Capital contributions	29		29	6		35	
Net movement in other comprehensive income	(69)	78	9		(9)		
Dividends paid to intermediate holding company	(120)		(120)	(15)		(135)	
Total movement in year	470	(91)	379	(4)	(10)	365	
Shareholders' funds at beginning of year	4,402	(405)	3,997	127	45	4,169	
Shareholders' funds at end of year	4,872	(496)	4,376	123	35	4,534	
Comprising:							
Jackson National Life						4,411	2,298
Broker-dealer and fund management						123	64
						4,534	2,362

12. US OPERATIONS – ADDITIONAL DETAIL ON BASIS OF PRESENTATION OF RESULTS CONTINUED

(i) The Valuation Basis of Debt Securities – Reversal of FAS 115 Effects

Under US GAAP, debt securities classified as 'available for sale' under Financial Accounting Standard (FAS) 115 are carried in the balance sheet at fair value with movements on unrealised appreciation accounted for directly within shareholders' reserves as 'Other Comprehensive Income'. By contrast, consistent with the ABI SORP, for Group reporting purposes, all fixed income securities are carried at amortised cost subject to provision for permanent diminution in value. This accounting treatment is appropriate as the securities are held as part of a portfolio of such securities intended to be held to maturity. Movements in unrealised appreciation arising from changes in the fair value of these securities do not feature as a part of the Group's UK GAAP accounting.

(ii) The Valuation Basis of Hedging Derivative Instruments – Reversal of FAS 133 Effects

Under FAS 133, all derivative instruments are recognised in the balance sheet at their fair values and changes in such fair values are recognised immediately in earnings unless specific hedging criteria are met. Jackson National Life uses derivatives (primarily interest rate swaps) to hedge certain risks in conjunction with its asset/liability management programme. However, Jackson National Life has elected not to incur the costs of restructuring its derivative contracts, segregating investment portfolios and adding the systems and personnel required to qualify for much stricter hedge accounting treatment.

Net earnings for Jackson National Life on a US GAAP basis reflect increased volatility owing to fair value fluctuations on its derivative instruments, particularly for interest rate swaps that are regularly used to manage risks associated with movements in interest rates. However, the largely offsetting change in the fair value of hedged investments will remain as an adjustment taken directly to shareholders' funds under US GAAP, as described in note (i). This position can be contrasted with the position under UK GAAP where hedge accounting for relevant derivative instruments is still appropriate. Accordingly, gains and losses recognised under FAS 133 are eliminated in order to comply with UK GAAP.

(iii) Minority Interests

The UK GAAP results are determined after adjustment for minority interests. For UK reporting purposes the segmental result of Jackson National Life reflects its proportionate interests in the results of two investment funds that are consolidated as quasi-subsidiaries.

(iv) Presentation of Investment Returns within the UK Basis Performance Statements

Profit (loss) on ordinary activities before tax

With the exception of the elimination of FAS 133 effects, as explained in note (ii), and revaluation gains on certain equity-based securities that are recorded within Other Comprehensive Income under US GAAP, the total profit (loss) under UK GAAP is the same as under US GAAP.

Operating profit

Under US GAAP, the convention is to refer to operating income as income before realised gains and losses and related amortisation of acquisition costs. Under UK GAAP, consistent with the ABI SORP, operating profit is determined after inclusion of long-term investment returns i.e. investment income and estimated long-term capital gains. Details of the method for determining long-term returns for Jackson National Life are explained in note 5.

(v) Exchange Rates

	US$ to £
Average rate for 2004 applied to profit and loss account	1.83
Year end rate 2004 applied to shareholders' funds	1.92

13. INVESTMENT INCOME

	Long-term business technical account		Non-technical account	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Income from:				
Land and buildings	**851**	908	**0**	0
Listed investments	**5,337**	5,146	**7**	10
Other investments	**615**	617	**109**	91
	6,803	6,671	**116**	101
Gains (losses) on the realisation of investments	**1,722**	651	**(1)**	5
Exchange gains	**801**	687	**0**	0
Total	**9,326**	8,009	**115**	106

14. LONG-TERM BUSINESS PROVISIONS, PREMIUMS AND POLICYHOLDERS' BONUSES

(i) Technical Provisions and Technical Provisions for Linked Liabilities

The following table provides an analysis of technical provisions between with-profits and non-participating business:

	2004 %	2003 %
Scottish Amicable Insurance Fund*	**9**	10
Financed by with-profits funds:		
With-profits business	**39**	41
Non-participating business†	**9**	9
Shareholder financed business:		
Non-participating business	**24**	23
Linked business	**19**	17
Total	**100**	100

(ii) Gross Premiums

The following table provides an analysis of gross premiums between with-profits and non-participating business:

	2004 %	2003 %
Scottish Amicable Insurance Fund*	**1**	2
Financed by with-profits funds:		
With-profits business	**19**	25
Non-participating business†	**1**	1
Shareholder financed business:		
Non-participating business	**60**	54
Linked business	**19**	18
Total	**100**	100

* The Scottish Amicable Insurance Fund is closed to new business. The assets and liabilities of the fund are wholly attributable to the policyholders of the fund.

† Annuity business written by Prudential Annuities Limited, a subsidiary of the with-profits fund of The Prudential Assurance Company Limited (PAC), and by a separate fund of the PAC with-profits fund, which comprises non-participating and linked business purchased from the Scottish Amicable Life Assurance Society.

(iii) Policyholders' Bonuses

Bonuses declared for the year in respect of the Group's with-profits business are included in the change in long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of policyholders' bonuses was £2,233m (£2,325m).

15. NET OPERATING EXPENSES

	Long-term business technical account		**General business technical account**	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Acquisition costs	**1,508**	1,188	**–**	–
Change in deferred acquisition costs	**(78)**	(3)	**–**	–
Administrative expenses	**530**	633	**1**	3
Amortisation of present value of acquired in-force business (note 27)	**25**	26	**–**	–
Total	**1,985**	1,844	**1**	3

Net operating expenses in the consolidated profit and loss account also include corporate expenditure of £83m (£67m) in the non-technical account.

16. INVESTMENT EXPENSES AND CHARGES

	Long-term business technical account		Non-technical account	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Interest payable on core structural borrowings	**–**	–	**154**	143
Interest on bank loans and overdrafts	**47**	40	**–**	–
Interest on other borrowings	**91**	92	**59**	46
Total interest payable	**138**	132	**213**	189
Investment management expenses	**384**	349	**–**	–
Total	**522**	481	**213**	189

Long-term business interest payable includes £78m (£81m) in respect of products in the nature of funding arrangements entered into by Jackson National Life.

Long-term business investment management expenses include management fees charged by M&G and the Group's US and Asia fund management operations and fees paid to external property managers.

Interest on other borrowings in the non-technical account includes £1m (£2m) in respect of non-recourse borrowings of investment funds managed by PPM America, £33m (£26m) in respect of Egg debenture loans and £25m (£18m) in respect of commercial paper and other borrowings that support a short-term fixed income securities reinvestment programme. Further details on borrowings are included in note 32.

17. INFORMATION ON STAFF AND PENSION COSTS

The average number of staff employed by the Group during the year were:

	2004	2003
UK and Europe Operations	**10,849**	11,473
US Operations	**2,589**	2,742
Asian Operations	**8,277**	6,797
Total	**21,715**	21,012

The costs of employment were:

	2004 £m	2003 £m
Wages and salaries	**762**	710
Social security costs	**62**	54
Other pension costs (see below)	**49**	48
Total	**873**	812

Pension Costs

The Group has chosen not to fully implement FRS 17 'Retirement benefits' for the 2004 financial statements. Pension costs shown above have been determined applying the principles of SSAP 24 'Pension costs'. £31m (£32m) of the costs related to defined benefit schemes and £18m (£16m) to defined contribution schemes. In addition, £15m (£12m) of the costs related to overseas defined contribution schemes.

Actuarial valuation and funding

The Group operates a number of pension schemes around the world. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This Scheme is primarily a defined benefit scheme but no employees with employment offers after 31 July 2003 are eligible for membership of the defined benefit section of the Scheme. On the FRS 17 basis of valuation described below, 90% of the liabilities of Group defined benefit schemes are accounted for within PSPS.

This Scheme has assets held in separate trustee administered funds and was last subject to a full triennial actuarial valuation as at 5 April 2002 by P N Thornton, a qualified actuary and a partner in the firm of Watson Wyatt Partners. The principal actuarial assumptions adopted were investment return 6.6% per annum, pensionable earnings growth 4.5% per annum, increases to pensions in payment 2.5% per annum and dividend growth 3.5% per annum.

The market value of Scheme assets as at that date was £4,034m and the actuarial value of the assets was sufficient to cover 110% of the benefits that had accrued to members, allowing for expected future increases in earnings. As a result of the actuarial valuation, the employers' contribution rate has continued at the minimum rate prescribed under the Scheme rules, which is 12.5% of salaries.

The employers' contribution is required to be paid as a minimum in future years irrespective of the excess of assets in the Scheme and, under the current Scheme rules, access to the surplus through refunds from the Scheme is not available. Accordingly the surplus is not recognised as an asset in the Group's financial statements and the pension cost charge has been determined on an accrued payable basis without regard to the spreading of the surplus in the fund that would normally be appropriate under the requirements of SSAP 24.

The Group also operates two smaller defined benefit schemes for UK employees in respect of Scottish Amicable and M&G activities, whose aggregate pension costs on a SSAP 24 basis are materially the same as the funding cost. For all three schemes the projected unit method was used for the most recent full actuarial valuations.

17. INFORMATION ON STAFF AND PENSION COSTS CONTINUED

FRS 17 basis disclosure

(i) Basis of valuation and scheme assets and liabilities

Using external actuarial advice provided by Watson Wyatt Partners for the valuation of PSPS and by Aon Limited for the M&G scheme, and internal advice for the Scottish Amicable scheme, the most recent full valuations have been updated to 31 December 2004 applying the principles prescribed by FRS 17.

The key assumptions adopted for the FRS 17 basis valuations were:

	31 Dec 2004	31 Dec 2003	31 Dec 2002
Price inflation	2.80%	2.70%	2.25%
Rate of increase in salaries	4.80%	4.70%	4.25%
Rate of increase of present and future pensions	2.80%	2.70%	2.25%
Rate used to discount scheme liabilities	5.30%	5.40%	5.50%

The assets in the schemes and the expected rates of return were:

	31 Dec 2004		31 Dec 2003		31 Dec 2002	
	Assets £m	Long-term expected rate of return	Assets £m	Long-term expected rate of return	Assets £m	Long-term expected rate of return
Equities	2,568	7.50%	2,671	7.75%	2,501	8.00%
Bonds	1,057	4.75%	639	5.00%	473	5.00%
Properties	533	6.80%	564	7.00%	536	7.75%
Other assets	62	4.80%	116	4.00%	60	4.00%
Total value of assets	4,220	6.68%	3,990	7.10%	3,570	7.50%

The long-term expected rates of return have been determined after applying due consideration to the requirements of paragraph 54 of FRS 17, in particular, taking account of the values of the assets and equity market levels at the balance sheet dates.

The present value of the liabilities of the three schemes at 31 December 2004 was £4,869m (31 December 2003 £4,592m). The resulting scheme deficit arising from the excess of liabilities over assets at 31 December 2004 comprised £494m attributable to the PAC with-profits fund and £155m attributable to shareholder operations. At 31 December 2003, the resulting scheme deficit comprised £457m attributable to the PAC with-profits fund and £145m attributable to shareholder operations.

The movements in the difference between scheme assets and liabilities were:

	31 Dec 2004 £m	31 Dec 2003 £m
Current service cost	(66)	(62)
Contributions	31	32
Other finance income	33	39
Actuarial losses	(45)	(64)
Net reduction	(47)	(55)

17. INFORMATION ON STAFF AND PENSION COSTS CONTINUED

(ii) Estimated pension scheme liability attributable to shareholder operations if FRS 17 had been adopted

Movements on the pension scheme liability attributable to shareholder operations that would have been recognised in the Group's primary statements had FRS 17 been implemented are as follows:

	Net pension liability attributable to shareholders 1 Jan 2004 £m	Profit and loss account charge attributable to shareholders (note (a)) £m	Actuarial losses attributable to shareholders (note (b)) £m	Contributions paid by shareholder operations £m	Net pension liability attributable to shareholders 31 Dec 2004 £m
Gross of tax liability	(145)	(14)	(8)	12	(155)
Related deferred tax	44	4	2	(4)	46
Net of tax liability	(101)	(10)	(6)	8	(109)

(a) Profit and loss charge attributable to shareholders
This comprises:

	2004 £m	2003 £m	2002 £m
Operating charge (all current service cost)	(66)	(62)	(65)
Finance income (expense):			
Interest on pension scheme liabilities	(243)	(222)	(212)
Expected return on pension scheme assets	276	261	300
	33	39	88
Total profit and loss account charge	(33)	(23)	23
less: amount attributable to PAC with-profits fund*	19	11	(24)
Profit and loss account charge attributable to shareholders	(14)	(12)	(1)

* Since shareholder profits in respect of the PAC with-profits fund are a function of the actuarially determined surplus for distribution, the overall profit and loss account result is not directly affected by the level of pension cost or other expenses.

(b) Actuarial losses attributable to shareholders
This comprises losses charged to the statement of total recognised gains and losses, after adjusting for amounts attributable to the PAC with-profits fund:

	2004 £m	2003 £m	2002 £m
Actual less expected return on pension scheme assets (3% (8%) ((26)%) of pension scheme assets)	115	311	(932)
Experience losses on scheme liabilities (0% (0%) (1%) of the present value of scheme liabilities)	(18)	(3)	(38)
Changes in assumptions underlying the present value of scheme liabilities	(142)	(372)	(219)
Total actuarial losses (1% (1%) (29%) of the present value of the scheme liabilities)	(45)	(64)	(1,189)
less: amounts attributable to the PAC with-profits fund	37	41	914
Pre-tax impact on the statement of total recognised gains and losses attributable to shareholders	(8)	(23)	(275)
Related deferred tax	2	7	82
Net amount attributable to shareholders' funds	(6)	(16)	(193)

(iii) Estimated pension scheme liability attributable to the PAC with-profits fund if FRS 17 had been adopted

Movements on the pension scheme liability attributable to the PAC with-profits fund that would have been recognised in the Group's primary statements had FRS 17 been implemented are as follows:

	Net pension liability attributable to PAC with-profits fund 1 Jan 2004 £m	Charge to long-term technical account attributable to PAC with-profits fund £m	Actuarial losses attributable to PAC with-profits fund £m	Contributions paid by PAC with-profits fund £m	Net pension liability attributable to PAC with-profits fund 31 Dec 2004 £m
Gross of tax liability	(457)	(19)	(37)	19	(494)
Related deferred tax	46	2	4	(2)	50
Net of tax liability	(411)	(17)	(33)	17	(444)

The apportionment of the deficit between the estimated amounts attributable to the PAC with-profits fund and shareholders' operations reflects the activities of the retired and active members of the schemes.

17. INFORMATION ON STAFF AND PENSION COSTS CONTINUED

Comparison of FRS 17 basis results with results on SSAP 24 basis

Balance sheet

	31 Dec 2004 SSAP 24 basis As published £m	31 Dec 2004 FRS 17 basis Memorandum information £m	31 Dec 2003 SSAP 24 basis As primary financial statements £m	31 Dec 2003 FRS 17 basis Memorandum information £m
Pension scheme liability attributable to shareholders and PAC with-profits fund (net of related deferred tax)	Nil*	(553)	Nil*	(512)
Fund for future appropriations	16,686	16,242	12,657	12,246
Shareholders' funds	4,281	4,172	3,240	3,139

* Surplus on actuarial basis of valuation not recognised due to minimum contribution requirement under Scheme rules (see page 80).

Profit and loss account

	SSAP 24 basis As primary financial statements 2004 £m	FRS 17 basis Memorandum information 2004 £m
Pension costs charged to technical accounts and non-technical account for defined benefit and defined contribution schemes	(49)	(51)
Tax charge attributable to long-term business charged to the long-term technical account	(896)	(896)
Transfer to fund for future appropriations charged to the long-term technical account	(4,025)	(4,025)
Operating profit before amortisation of goodwill	583	581

18. DIRECTORS' REMUNERATION

Information on directors' remuneration is given in the Remuneration Report on pages 42 to 52. Apart from the transactions with directors shown below, no director had an interest in shares, transactions or arrangements which requires disclosure, other than those given in the above Report.

	Number of persons	£000
Mortgages and other borrowings from Egg plc at 31 December 2004	**4**	**171**

These transactions are on normal commercial terms and in the ordinary course of business.

19. FEES PAYABLE TO AUDITORS

	2004 £m	2003 £m
Audit services:		
Statutory audit fees	**3.8**	3.6
US GAAP reporting	**0.8**	0.7
Regulatory audit	**0.9**	0.5
Achieved profits basis audits	**0.1**	0.1
Total audit services	**5.6**	4.9
Further assurance services associated with:		
Implementation of Sarbanes-Oxley requirements	**1.8**	0.2
Prospectuses for equity and debt issues	**0.5**	–
Implementation of regulatory requirements	**0.4**	–
Tax compliance	**0.2**	0.3
Comfort and attestation letters	**0.2**	0.2
Other services:		
Acquisitions and disposals due diligence	**0.5**	–
Other services	**0.5**	1.2
Total	**9.7**	6.8

Statutory audit fees include £0.1m (£0.1m) in respect of the Company. Fees, excluding statutory audit fees, payable to KPMG Audit Plc and its associates include £4.6m (£3.0m) for work performed in the UK.

The Audit Committee regularly monitors the non-audit services provided to the Group by its auditors and has developed a formal Auditor Independence Policy which sets out the types of services that the auditors may provide, consistent with the guidance in Sir Robert Smith's report 'Audit Committees – Combined Code Guidance' and with the provisions of the US Sarbanes-Oxley Act. The Audit Committee annually reviews the auditors' objectivity and independence. More information on these issues is given in the Corporate Governance Report on page 36.

20. TAX

(i) Profit and Loss Account Tax Charge (Credit)

The tax expense for certain long-term business operations is attributable to shareholders and policyholders. The shareholders' portion of tax is determined using the long-term tax rate of the underlying business applied to the profits transferred to the non-technical account. A summary of the tax expense attributable to the long-term business technical account and shareholders' profits in the non-technical account is shown below:

(a) Between current and deferred tax expense (benefit)	Long-term business technical account (attributable to long-term funds) 2004 £m	2003 £m	Non-technical account (attributable to shareholders' profits) 2004 £m	2003 £m
Current:				
UK	**464**	279	**55**	49
Foreign	**76**	102	**199**	126
	540	381	**254**	175
Deferred:				
UK	**262**	436	**(29)**	(27)
Foreign	**94**	7	**7**	(4)
	356	443	**(22)**	(31)
Total	**896**	824	**232**	144

(b) By category of tax expense (benefit)	Long-term business technical account (attributable to long-term funds) 2004 £m	2003 £m	Non-technical account (attributable to shareholders' profits) 2004 £m	2003 £m
UK corporation tax	**447**	318	**(43)**	(38)
Double tax relief	**(18)**	(15)	**–**	(3)
Overseas tax	**75**	102	**87**	61
Adjustments in respect of prior years – UK	**35**	(24)	**1**	(13)
– Overseas	**1**	–	**–**	–
	540	381	**45**	7
Deferred tax	**356**	443	**(8)**	(13)
	896	824	**37**	(6)
Shareholder tax attributable to balance on the long-term business technical account:				
Current			**209**	168
Deferred			**(14)**	(18)
			195	150
Total	**896**	824	**232**	144

(c) By source of profit	2004 £m	2003 £m
Long-term business operations:		
UK and Europe	**85**	78
Jackson National Life	**72**	58
Asian Operations	**38**	14
Total long-term business	**195**	150
Other operations	**(18)**	(44)
Total tax on operating profit (based on long-term investment returns)	**177**	106
Tax on short-term fluctuations in investment returns	**68**	38
Tax on profit on business disposals	**19**	–
Tax on Egg France closure cost	**(32)**	–
Tax on profit on ordinary activities (including tax on actual investment returns)	**232**	144

(d) Factors affecting tax charge for the period

The tax assessed in the period is higher than the standard rate of corporation tax in the UK and the differences are explained on the following page. The standard rate of tax has been determined by using the UK rate of corporation tax enacted for the period for which the profits will be taxed.

20. TAX CONTINUED

(d) Factors affecting tax charge for the period continued

	2004 £m	2003 £m
Profit on ordinary activities before tax	**650**	350
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (30%)	**195**	105
Effects of:		
Differences in basis between taxable gains and book gains	**(8)**	3
Different tax rates on overseas earnings	**6**	13
Deferred tax not recognised on tax losses carried forward	**19**	21
Different tax bases of long-term insurance (current and deferred)	**(15)**	(12)
Non-taxable amortisation of goodwill	**29**	30
Adjustments in relation to prior years	**(13)**	(10)
Capital allowances for period in excess of depreciation for the period	**–**	(4)
Short-term timing differences	**11**	11
Other	**30**	18
Current tax charge for the period	**254**	175

(e) Factors that may affect future tax charges

The possible tax benefit of approximately £430m, which may arise from capital losses valued at approximately £1.7bn, is sufficiently uncertain that it has not been recognised. The circumstances in which the amount would be recoverable are a combination of the following: the agreement of the value of the losses with the Inland Revenue, the availability of future capital profits that are within the charge to capital gains tax and the agreement of the Inland Revenue to the utilisation of the losses against certain capital gains arising in the UK long-term business operations.

(ii) Deferred Tax

The components of the net deferred tax liability are as follows. The balances have not been discounted.

	Liability provided (asset recognised)	
	2004 £m	2003 £m
(a) By category of timing difference		
Unrealised gains on investments	**1,489**	1,205
Deferred acquisition costs	**403**	408
Short-term timing differences	**(560)**	(626)
Long-term business technical provisions and other insurance items	**213**	204
Capital allowances	**(23)**	(37)
Total	**1,522**	1,154
(b) By fund		
Scottish Amicable Insurance Fund	**125**	87
PAC with-profits fund*	**1,448**	1,225
Jackson National Life	**(85)**	(172)
Other long-term business operations	**88**	50
Other operations	**(54)**	(36)
Total	**1,522**	1,154

* Includes deferred tax charges in respect of non-participating annuity business written by a subsidiary, Prudential Annuities Limited, financed by the PAC with-profits fund.

A potential deferred tax asset of £114m (£115m), which may arise from trading losses of approximately £408m (£378m), is sufficiently uncertain that it has not been recognised. With regard to £100m (£104m) of the asset, the trading losses would be recoverable only if there were sufficient future trading profits in the jurisdictions where the losses have arisen. The balance is dependent upon the outcome of a case before the European Court of Justice regarding Group relief claims in connection with European subsidiaries.

	2004 £m	2003 £m
(c) Reconciliation of movement in deferred tax		
Deferred tax liability at beginning of year	**1,154**	696
Exchange movements	**20**	28
Deferred tax charged to profit and loss account for the year	**348**	430
Deferred tax liability at end of year	**1,522**	1,154

21. GOODWILL

	2004 £m	2003 £m
Balance at beginning of year	**1,504**	1,604
Charge to profit and loss account:		
Amortisation	**(97)**	(98)
Writedown in respect of Funds Direct included in Egg result	**(2)**	–
Writedown in respect of Zebank included in Egg France closure cost	**(3)**	–
Goodwill of Jackson Federal Bank taken into account on profit on sale of £41m	**(35)**	–
Adjustment in respect of Korea	**–**	(2)
Balance at end of year	**1,367**	1,504

The balance at beginning of year comprises cost of £1,933m (£1,935m) less accumulated amortisation of £429m (£331m). The cumulative goodwill charged directly to shareholders' funds in respect of acquisitions prior to 1998 amounted to £589m (£589m).

22. LAND AND BUILDINGS

	2004 £m	2003 £m
Current value:		
Freehold	**7,650**	6,624
Leasehold with a term of over 50 years	**4,497**	4,153
Leasehold with a term of less than 50 years	**220**	188
Total	**12,367**	10,965

The cost of land and buildings was £7,919m (£7,490m). The value of land and buildings occupied by the Group was £186m (£181m).

23. INVESTMENTS IN PARTICIPATING INTERESTS

	Cost		Carrying value	
	2004 £m	2003 £m	2004 £m	2003 £m
Interests in associate undertakings	**18**	23	**4**	9
Share of joint ventures:				
Gross assets			**110**	67
Gross liabilities			**(88)**	(44)
Interests in joint ventures	**46**	40	**22**	23
Other participating interest	**–**	24	**–**	24
Total	**64**	87	**26**	56

A summary of the movement in interests in associate undertakings is set out below:

	Share of capital 2004 £m	Share of reserves 2004 £m	Goodwill 2004 £m	Total carrying value 2004 £m
Disposal	**(2)**	**1**	**(2)**	**(3)**
Amortisation of goodwill			**(2)**	**(2)**
Movement in year	**(2)**	**1**	**(4)**	**(5)**
Balance at beginning of year	**6**	**(7)**	**10**	**9**
Balance at end of year	**4**	**(6)**	**6**	**4**

The only associate undertaking at the end of the year is IfOnline plc, a company whose principal activity is mortgage intermediation. Egg plc has a 39% share in the share capital of IfOnline plc. In September 2004, the Company sold its other associate undertaking, a 25% share in the share capital of Hazell Carr Pensions Consulting plc, for £5m. The profit on sale before tax of £2m is included in investment income in the long-term business technical account. The amount of operating profit attributable to these undertakings was £nil (loss of £2m).

In accordance with FRS 9, 'Associates and joint ventures', investments held as part of the investment portfolio, rather than as undertakings through which the Company carries out its business, are accounted for as other financial investments in note 24 and not as investments in participating interests.

Interests in joint ventures mainly reflect long-term insurance business operations with the Bank of China in Hong Kong and ICICI in India. Group operating profit included losses of £6m (losses of £5m) incurred by these operations. In August 2004, the Company sold its 15% interest in Life Assurance Holding Corporation Limited and realised a profit on sale of £7m before tax.

24. OTHER FINANCIAL INVESTMENTS

	Cost 2004 £m	Cost 2003 £m	Current value 2004 £m	Current value 2003 £m
Shares and other variable yield securities and units in unit trusts	**25,017**	23,987	**38,426**	34,877
Debt securities and other fixed income securities – carried at market value	**45,373**	43,169	**47,319**	44,586
Debt securities and other fixed income securities – carried at amortised cost	**19,529**	20,093	**19,431**	20,005
Loans secured by mortgages	**2,742**	2,783	**2,802**	2,815
Loans to policyholders secured by insurance policies	**707**	716	**707**	716
Other loans	**67**	84	**83**	100
Deposits with credit institutions	**6,125**	4,088	**6,125**	4,088
Other investments	**2,174**	1,935	**2,369**	2,032
Total	**101,734**	96,855	**117,262**	109,219

	2004 £m	2003 £m
Amounts included in the above relating to listed investments were:		
Shares and other variable yield securities and units in unit trusts	**37,429**	33,584
Debt securities and other fixed income securities – carried at market value	**39,046**	37,351
Debt securities and other fixed income securities – carried at amortised cost	**15,022**	17,322
Total	**91,497**	88,257

Consistent with the Group's accounting policy set out on page 69, amortised cost has been applied as current value for certain fixed income securities. Where appropriate, the current value of such investments has been reduced to impaired value.

The market value of debt securities and other fixed income securities carried at amortised cost was £20,426m (£21,202m). All debt securities carried at amortised cost are held by long-term business operations.

For those debt securities and other fixed income securities carried at amortised cost where the maturity value exceeded purchase price, the unamortised difference at the year end was £134m (£199m). For securities carried at amortised cost where the purchase price exceeded maturity value, the unamortised difference at the year end was £388m (£360m).

25. ASSETS HELD TO COVER LINKED LIABILITIES

	Cost 2004 £m	Cost 2003 £m	Current value 2004 £m	Current value 2003 £m
Assets held to cover linked liabilities	**20,524**	18,621	**23,830**	19,921

Current value includes £5,218m (£4,537m) in respect of managed funds.

26. TANGIBLE ASSETS

	2004 £m	2003 £m
Cost:		
Balance at beginning of year	**450**	460
Exchange movement	**(12)**	(17)
Additions	**49**	65
Disposals	**(17)**	(58)
Balance at end of year	**470**	450
Depreciation:		
Balance at beginning of year	**(266)**	(264)
Exchange movement	**6**	11
Provided during year	**(65)**	(64)
Disposals	**10**	51
Balance at end of year	**(315)**	(266)
Net book value at end of year	**155**	184
Net book value at beginning of year	**184**	196

27. PRESENT VALUE OF ACQUIRED IN-FORCE LONG-TERM BUSINESS

	2004 £m	2003 £m
Balance at beginning of year	**108**	133
Exchange movement	**(5)**	(7)
Amortisation:		
Pre-tax	**(25)**	(26)
Tax	**8**	8
Net	**(17)**	(18)
Balance at end of year	**86**	108

The balance at beginning of year comprises cost of £256m (£272m) less accumulated amortisation of £103m (£82m) and tax of £45m (£57m).

28. SHARE CAPITAL AND SHARE PREMIUM

The authorised share capital of the Company is £170m (divided into 3,000,000,000 ordinary shares of 5 pence each and 2,000,000,000 sterling preference shares of 1 pence each) and US$20m (divided into 2,000,000,000 US dollar preference shares of 1 cent each) and €20m (divided into 2,000,000,000 Euro preference shares of 1 cent each). None of the preference shares has been issued. A summary of the ordinary shares in issue is set out below:

Issued shares of 5 pence each fully paid	Number of shares	Share capital 2004 £m	Share premium 2004 £m
At beginning of year	**2,009,176,830**	**100**	**553**
Shares issued under Rights Issue, net of expenses	**339,011,347**	**17**	**1,004**
Shares issued under share option schemes	**567,121**	**–**	**1**
Shares issued in lieu of cash dividends	**26,637,722**	**2**	**116**
Transfer to retained profit in respect of shares issued in lieu of cash dividends			**(116)**
At end of year	**2,375,393,020**	**119**	**1,558**

In October 2004, the Company announced a 1 for 6 Rights Issue at 308 pence per new share. The Rights Issue raised £1,044m and issue expenses were £23m.

At 31 December 2004 there were options subsisting under share option schemes to subscribe for 13,254,966 (15,788,315) shares at prices ranging from 266 pence to 723 pence (266 pence to 723 pence, as restated to take account of the 2004 Rights Issue) and exercisable by the year 2011 (2010).

The Company has established trusts to facilitate the delivery of shares under employee incentive plans and savings-related share option schemes. In 2004 the Company purchased 1.0m shares in respect of employee incentive plans at a cost of £4m. At 31 December 2004, 10.6m Prudential plc shares with a market value of £48m were held in such trusts. This was also the maximum number held at any time during the year. Of this total, 5.4m shares were held by trusts under employee incentive plans. The cost of acquiring Prudential plc shares held in these trusts of £42m (£38m) has been shown as a deduction from shareholders' funds.

In addition, 5.2m shares were held by a qualifying employee share ownership trust. These shares are expected to be fully distributed in the future on maturity of savings-related share option schemes at a weighted average exercise price of 277 pence.

29. INVESTMENTS OF THE COMPANY

	Shares in subsidiary undertakings 2004 £m	Loans to subsidiary undertakings 2004 £m
At beginning of year	**4,000**	**2,526**
Transfer from other subsidiary undertaking	**608**	**–**
Investment in subsidiary undertaking	**1,021**	**–**
Exchange rate movements	**–**	**(13)**
Net repayment of loans	**–**	**(351)**
Provision against loans	**–**	**(33)**
At end of year	**5,629**	**2,129**

30. PROFIT OF THE COMPANY

The profit of the Company for the year was £124m (£186m). After dividends of £361m (£320m) and a transfer from the share premium account of £116m (£27m) in respect of shares issued in lieu of cash dividends, retained profit at 31 December 2004 amounted to £848m (£969m).

31. SUBSIDIARY UNDERTAKINGS

The principal subsidiary undertakings of the Company at 31 December 2004, all wholly owned except Egg Banking plc and PCA Life Assurance Company Limited were:

	Main activity	Country of incorporation
The Prudential Assurance Company Limited	Insurance	England and Wales
Prudential Annuities Limited*	Insurance	England and Wales
Prudential Retirement Income Limited*	Insurance	Scotland
M&G Investment Management Limited*	Investment management	England and Wales
Egg Banking plc*	Banking	England and Wales
Jackson National Life Insurance Company*	Insurance	US
Prudential Assurance Company Singapore (Pte) Limited*	Insurance	Singapore
PCA Life Assurance Company Limited*	Insurance	Taiwan

* Owned by a subsidiary undertaking of the Company.

Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation, except for Prudential Retirement Income Limited which operates mainly in England and Wales. Egg Banking plc is a subsidiary of Egg plc, a listed subsidiary of the Company. The ordinary shares of Egg plc, of which there is only one class, are 78% owned by the Company, 1% owned by other companies within the Prudential Group and 21% owned by shareholders external to the Prudential Group. At 31 December 2004, the ordinary shares of PCA Life Assurance Company Limited were 97% owned by the Company. In February 2005 this increased to 99%.

32. BORROWINGS

	Long-term loans		Amounts owed to credit institutions		Other borrowings		Total	
	2004 £m	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Core structural borrowings of shareholder financed operations:								
Holding company and finance subsidiaries:								
US$250m 7.125% Bonds 2005^	**130**	140					**130**	140
£150m 9.375% Guaranteed Bonds 2007	**150**	150					**150**	150
£250m 5.5% Bonds 2009^	**250**	250					**250**	250
€500m 5.75% Subordinated Notes 2021^† (note (i))	**351**	349					**351**	349
£300m 6.875% Bonds 2023^	**300**	300					**300**	300
£250m 5.875% Bonds 2029^	**250**	250					**250**	250
£435m 6.125% Subordinated Notes 2031^†	**426**	426					**426**	426
US$1,000m 6.5% Perpetual Subordinated Capital Securities^† (note (ii))	**512**	547					**512**	547
US$250m 6.75% Perpetual Subordinated Capital Securities^†	**126**	–					**126**	–
Floating Rate Guaranteed Unsecured Notes 2004					**–**	21	**–**	21
€20m Medium Term Subordinated Notes 2023^ (note (iii))	**14**	14					**14**	14
Commercial paper 2005^					**171**	–	**171**	–
Jackson National Life:								
US$250m 8.15% Surplus Notes 2027	**130**	140					**130**	140
Currency translation net asset on swap transactions					**(13)**	(20)	**(13)**	(20)
Total core structural borrowings of shareholder financed operations	**2,639**	2,566			**158**	1	**2,797**	2,567
Other borrowings of shareholders' funds:								
Bank loans and overdrafts			**17**	16			**17**	16
Obligations under finance leases			**2**	3			**2**	3
Commercial paper 2005^ (note (iv))					**1,057**	1,041	**1,057**	1,041
Medium Term Notes (note (iv))					**9**	10	**9**	10
Currency translation net liability on swap transactions (note (iv))					**13**	23	**13**	23
Non-recourse borrowings of investment subsidiaries managed by PPM America (note (v))			**128**	153	**55**	61	**183**	214
Egg debenture loans (note (vi)):								
£250m 7.5% Subordinated Notes 2013	**249**	249					**249**	249
£200m 6.875% Subordinated Notes 2021	**202**	202					**202**	202
Other borrowings of long-term business operations:								
Scottish Amicable Finance plc (note (vii)):								
£100m 8.5% Undated Subordinated Guaranteed Bonds	**100**	100					**100**	100
Bank loans and overdrafts			**44**	20			**44**	20
Total borrowings	**3,190**	3,117	**191**	192	**1,292**	1,136	**4,673**	4,445

^ Borrowings issued by the holding company. The interests of the holders of the Subordinated Notes and the Subordinated Capital Securities are subordinate to the entitlements of other creditors of the holding company.

† Net of issue costs.

32. BORROWINGS CONTINUED

	Long-term loans		Amounts owed to credit institutions		Other borrowings		Total	
	2004 £m	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Borrowings are repayable as follows:								
Within one year or on demand	**130**	–	**55**	46	**1,248**	1,095	**1,433**	1,141
Between one and two years	**–**	140	**8**	17	**–**	–	**8**	157
Between two and five years	**400**	150	**–**	–	**–**	–	**400**	150
After five years	**2,660**	2,827	**128**	129	**44**	41	**2,832**	2,997
Total borrowings	**3,190**	3,117	**191**	192	**1,292**	1,136	**4,673**	4,445
Reconciliation to cash flow statement disclosures (note 35):								
Shareholders' funds	**2,960**	2,877	**147**	172	**1,292**	1,136	**4,399**	4,185
Long-term business operations	**230**	240	**44**	20	**–**	–	**274**	260
Total borrowings	**3,190**	3,117	**191**	192	**1,292**	1,136	**4,673**	4,445
Recorded in the consolidated balance sheet on page 61 as:								
Subordinated liabilities	**1,429**	1,336						
Debenture loans	**1,761**	1,781						
	3,190	3,117						

(i) The €500m 5.75% borrowings have been swapped into borrowings of £333m with interest payable at 6 month £Libor plus 0.962%.

(ii) Interest on the US$1,000m 6.5% borrowings has been swapped into floating rate payments at 3 month US$Libor plus 0.80%.

(iii) The €20m Medium Term Subordinated Notes were issued at 20-year Euro Constant Maturity Swap (capped at 6.5%). At 31 December 2004 these had been swapped into borrowings of £14m with interest payable at 3 month £Libor plus 1.2%.

(iv) These borrowings support a short-term fixed income securities reinvestment programme.

(v) Non-recourse borrowings issued by investment subsidiaries managed by PPM America include secured senior and subordinated debt. The senior debt is secured on the investments held by the relevant subsidiaries. Interest rates on the senior debt are variable based on a market rate and mostly ranged from 1.57% to 2.38% (1.57% to 2.16%). The interests of the holders of the subordinated debt issued by these subsidiaries are subordinate to the entitlements of the holders of the senior debt. In addition to the debt of these subsidiaries, PPM America manages investment companies with liabilities of £753m (£943m) pertaining to debt instruments issued to external parties. In all instances the holders of the debt instruments issued by these subsidiaries and other companies do not have recourse beyond the assets of those subsidiaries.

(vi) The interests of the holders of the Notes issued by Egg plc as structured debt capital are subordinate to the entitlements of other creditors of that operation. At 31 December 2004, Egg had also issued unsubordinated debt securities totalling £1,807m (£1,423m) and sold securities under agreements to repurchase totalling £131m (£829m) as part of its trading activities.

(vii) The interests of the holders of the Bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund of The Prudential Assurance Company Limited, are subordinate to the entitlements of the policyholders of that fund.

(viii) Jackson National Life has entered into a programme of funding arrangements under contracts which, in substance, are almost identical to Guaranteed Investment Contracts. The liabilities under these funding arrangements totalled £2,862m (£3,247m). In addition, Jackson National Life has entered into stocklending arrangements. Obligations under these arrangements totalled £446m (£515m). These amounts are shown on the consolidated balance sheet within creditors.

(ix) Under the terms of the Group's arrangements with its main UK banker, the bank has a right of set off between credit balances (other than those of long-term funds) and all overdrawn balances of those Group undertakings with similar arrangements.

33. CONTINGENCIES AND RELATED OBLIGATIONS

Consistent with FRS 12, 'Provisions, contingent liabilities and contingent assets', appropriate provision has been made in the financial statements where the Group has an obligation arising from the events or activities described below where a realistic estimate of the obligation can be made, but not for contingent liabilities.

Litigation

Jackson National Life has been named in civil proceedings, which appear to be substantially similar to other class action litigation brought against many life insurers in the US, alleging misconduct in the sale of insurance products. At this time, it is not possible to make a meaningful estimate of the amount or range of loss, if any, that could result from an unfavourable outcome in such actions. In addition, Jackson National Life is a defendant in individual actions that involve similar issues.

The Group is involved in other litigation and regulatory issues arising in the ordinary course of business. Whilst the outcome of such matters cannot be predicted with certainty, the directors believe that the ultimate outcome of such litigation will not have a material adverse effect on the Group's financial condition, results of operations or cash flows.

Pension Mis-Selling Review

In 1988, the UK government introduced new pensions legislation intended to encourage more individuals to make their own arrangements for their pensions. During the period from April 1988 to June 1994, many individuals were advised by insurance companies, Independent Financial Advisers and other intermediaries to not join, to transfer from or to opt out of their occupational pension schemes in favour of private pension products introduced under the UK Income and Corporation Taxes Act 1988. The UK insurance regulator (previously the Personal Investment Authority, now the Financial Services Authority, (FSA)) subsequently determined that many individuals were incorrectly advised and would have been better off not purchasing the private pension products sold to them. Industry participants are responsible for compensating the persons to whom private pensions were mis-sold. As a result, the FSA required that all UK life insurance companies review their potential cases of pension mis-selling and pay compensation to policyholders where necessary and, as a consequence, record a provision for the estimated costs. The Group met the requirement of the FSA to issue offers to all cases by 30 June 2002.

Provisions in respect of the costs associated with the review have been included in the change in the long-term business provision in the Group's profit and loss account and the transfer to or from the fund for future appropriations has been determined accordingly. The following is a summary of the changes in the pension mis-selling provision for the years ended 31 December 2004 and 31 December 2003:

	2004 £m	2003 £m
Balance at beginning of year	**530**	730
Changes to actuarial assumptions and method of calculation	**(32)**	(131)
Discount unwind	**22**	21
Redress to policyholders	**(26)**	(56)
Payment of administrative costs	**(7)**	(34)
Balance at end of year	**487**	530

Every year the FSA updates the actuarial assumptions to be used in calculating the provision, including interest rates and mortality assumptions. The pension mis-selling provision represents the discounted value of future expected payments, including benefit payments and all internal and external legal and administrative costs of adjudicating, processing and settling those claims. To the extent that amounts have not been paid, the provision increases each year reflecting the shorter period of discount.

The directors believe that, based on current information, the provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling as well as the costs and expenses of the Group's pension review unit established to identify and settle such cases. Such provision represents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The costs associated with the mis-selling review have been met from the inherited estate. Accordingly, these costs have not been charged to the asset shares used in the determination of policyholder bonus rates. Hence policyholders' pay-out values have been unaffected by pension mis-selling.

In 1998, Prudential stated that deducting mis-selling costs from the inherited estate would not impact its bonus or investment policy and it gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing.

This review was completed on 30 June 2002 and consequently the assurance has not applied to new business issued since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The assurance will continue to apply to any policy in force as at 31 December 2003, both for premiums paid before 1 January 2004 and for subsequent regular premiums (including future fixed, retail price index or salary related increases and Department of Work and Pensions rebate business). The maximum amount of capital support available under the terms of the assurance will reduce over time as claims are paid on the policies covered by it.

33. CONTINGENCIES AND RELATED OBLIGATIONS CONTINUED

Pension Mis-selling Review continued

The bonus and investment policy for each type of with-profits policy is the same irrespective of whether or not the assurance applies. Hence removal of the assurance for new business has had no impact on policyholder returns and this is expected to continue for the foreseeable future.

Free Standing Additional Voluntary Contribution Business Review

In February 2000, the FSA ordered a review of Free Standing Additional Voluntary Contribution business, which constitutes sales of personal pensions to members of company pension schemes. Individuals who purchased these pensions instead of the Additional Voluntary Contributions (AVC) scheme connected to their company's pension scheme may have been in a better financial position investing their money, and any matching contributions from their employers, in their company's AVC scheme. The FSA's review was to ensure that any employees disadvantaged due to not being properly informed of the benefits foregone from not investing in their AVC scheme were compensated.

The review required companies to identify relevant investors and to contact them with an offer to review their individual case. The Group met the deadline set by the FSA to issue offers to all cases by 31 December 2002. As a result of the review, the Group held a provision of £2m at 31 December 2004.

Mortgage Endowment Products Review

In common with several other UK insurance companies, the Group used to sell low-cost endowment products related to repayment of residential mortgages. At sale, the initial sum assured is set at a level such that the projected benefits, including an estimate of the annual bonus receivable over the life of the policy, will equal or exceed the mortgage debt. Because of a decrease in expected future investment returns since these products were sold, the FSA is concerned that the maturity value of some of these products will be less than the mortgage debt. The FSA has worked with insurance companies to devise a programme whereby the companies write to customers indicating whether they may have a possible shortfall and outline the actions that the customers can take to prevent this possibility.

The Group is exposed to mortgage endowment products in respect of policies issued by Scottish Amicable Life plc (SAL) and policies issued by Scottish Amicable Life Assurance Society (SALAS) and transferred into the Scottish Amicable Insurance Fund (SAIF). Provisions of £7m in SAL and £47m in SAIF were held at 31 December 2004 to cover potential compensation in respect of mortgage endowment product mis-selling claims. As SAIF is a separate sub-fund of the Prudential Assurance long-term business fund, this provision has no impact on shareholders. In addition, Prudential Assurance's main with-profits fund paid compensation of £16m in respect of mortgage endowment products mis-selling claims and held a provision of £61m at 31 December 2004 to cover further claims. This provision has no impact on the Group's profit before tax.

Guaranteed Annuities

Prudential Assurance used to sell guaranteed annuity products in the UK and held a provision of £49m at 31 December 2004 within the main with-profits fund to honour guarantees on these products. The Group's main exposure to guaranteed annuities in the UK is through the Scottish Amicable Insurance Fund (SAIF) and a provision of £648m was held in SAIF at 31 December 2004 to honour the guarantees. As SAIF is a separate sub-fund of the Prudential Assurance long-term business fund, this provision has no impact on shareholders.

Guarantees and Commitments

Guarantee funds in both the UK and the US provide for payments to be made to policyholders on behalf of insolvent life insurance companies. These guarantee funds are financed by payments assessed on solvent insurance companies based on location, volume, and types of business. The Group estimated its reserve for future guarantee fund assessments for Jackson National Life to be £10m at 31 December 2004. Similar assessments for the UK businesses were not significant. The directors believe that the reserve is adequate for all anticipated payments for known insolvencies.

Jackson National Life has commitments for future payments related to equity index call options totalling £8m at 31 December 2004. These commitments are accounted for on a deferred basis and therefore are off-balance sheet. The commitments were entered into in the normal course of business to hedge obligations associated with the issuance of equity index-linked immediate and deferred annuities and fall due for payment over the next three years.

Jackson National Life has unfunded commitments related to its investments in limited partnerships totalling £157m at 31 December 2004. These commitments were entered into in the normal course of business and the directors do not expect a material adverse impact on the operations to arise from them.

The Group has provided, from time to time, certain guarantees and commitments to third parties including funding the purchase or development of land and buildings and other related matters. At 31 December 2004, the aggregate amount of commitments and guarantees in respect of land and buildings was approximately £42m.

The Group has provided, from time to time, other guarantees and commitments to third parties entered into in the normal course of business but the directors do not consider that the amounts involved are significant.

33. CONTINGENCIES AND RELATED OBLIGATIONS CONTINUED

Other Matters

Prudential Assurance's inherited estate

The assets of the main with-profits fund within the long-term fund of Prudential Assurance comprise the amounts that the Company expects to pay out to meet its obligations to existing policyholders and an additional amount used as working capital. The amount payable over time to policyholders from the with-profits fund is equal to the policyholders' accumulated asset shares plus any additional payments that may be required by way of smoothing or to meet guarantees. The balance of the assets of the with-profits fund is called the 'inherited estate' and has accumulated over many years from various sources.

The inherited estate represents the major part of the working capital of Prudential Assurance's long-term fund which enables the Company to support with-profits business by providing the benefits associated with smoothing and guarantees, by providing investment flexibility for the fund's assets, by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus and investment policies. The size of the inherited estate fluctuates from year-to-year depending on the investment return and the extent to which it has been required to meet smoothing costs, guarantees and other events.

The Group believes that it would be beneficial if there were greater clarity as to the status of the inherited estate and therefore it has discussed with the Financial Services Authority the principles that would apply to any re-attribution of the inherited estate. No conclusions have been reached. Furthermore, the Group expects that the entire inherited estate will need to be retained within the long-term fund for the foreseeable future to provide working capital and so it has not considered any distribution of the inherited estate to policyholders and shareholders.

Support of long-term business funds by shareholders' funds

As a proprietary insurance company, the Group is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets, represented by the Fund for Future Appropriations, in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers (the excess assets) in the long-term funds could be materially depleted over time, by, for example, a significant or sustained equity market downturn, costs of significant fundamental strategic change, or a material increase in the pension mis-selling provision. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Group's ability to satisfy policyholders' reasonable expectations 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.

In 1997, the business of Scottish Amicable Life Assurance Society, a mutual society, was transferred to Prudential Assurance. In effecting the transfer, a separate sub-fund, the Scottish Amicable Insurance Fund (SAIF), was established within Prudential Assurance's long-term business fund. This sub-fund contains all the with-profits business and all other pension business that was transferred. No new business has been or will be written in the sub-fund and the sub-fund is managed to ensure that all the invested assets are distributed to SAIF policyholders over the lifetime of the SAIF policies. With the exception of certain amounts in respect of the unitised with-profits life business, all future earnings arising in SAIF are retained for SAIF policyholders. Any excess (deficiency) of revenue over expense within SAIF during a period is offset by a transfer to (from) the SAIF fund for future appropriations. Shareholders have no interest in the profits of SAIF but are entitled to the investment management fees paid on this business. With the exception of certain guaranteed annuity products mentioned earlier in this note, the majority of SAIF with-profits policies do not guarantee minimum rates of return to policyholders.

Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the Prudential Assurance long-term fund would be liable to cover any such deficiency. At 31 December 2004, the excess of SAIF assets over guaranteed benefits was £1,836m. Due to the quality and diversity of the assets in SAIF, the excess of assets stated above and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the directors believe that the probability of either the Prudential Assurance long-term fund or the Group's shareholders' funds having to contribute to SAIF is remote.

34. ACQUISITIONS AND DISPOSALS

Acquisitions

In November 2004, Jackson National Life entered into an agreement to buy Life Insurance Company of Georgia from ING Groep NV for £137m. The purchase is subject to regulatory approval.

Disposals

In August 2004, the Company sold its interest in Life Assurance Holding Corporation Limited for £41m. After taking into account the carrying value of the investment of £34m at the date of disposal, the profit on sale was £7m before tax.

In October 2004, Jackson National Life sold Jackson Federal Bank for £166m. After taking into account net assets and goodwill totalling £125m at the date of disposal, the profit on sale was £41m before tax. Jackson Federal Bank, which has been treated as discontinued operations in these financial statements, made an operating profit up to the date of disposal of £17m (£22m).

Both of the above investments were held by long-term business funds of the Group. Accordingly the proceeds from these disposals do not feature in the Group's consolidated cash flow statement.

35. CASH FLOW

Reconciliation of Operating Profit to Net Cash Inflow from Operations

	2004 £m	2003 £m
Operating profit before amortisation of goodwill	**583**	357
Add back interest charged to operating profit	**213**	189
Adjustments for non-cash items:		
Tax on long-term business profits	**(195)**	(150)
Amounts retained and invested in long-term business operations	**(579)**	(242)
Increase in net banking business assets	**(24)**	(223)
Other items	**95**	157
Net cash inflow from operating activities	**93**	88

Changes in Investments Net of Financing

	2004 £m	2003 £m
Increase in cash and short-term deposits, net of overdrafts	**12**	481
Net purchases (sales) of portfolio investments	**843**	(149)
Increase in loans	**(111)**	(829)
Reduction in credit facility utilised by investment subsidiaries managed by PPM America	**31**	151
Share capital issued, net of expenses of £23m (£nil)	**(1,140)**	(30)
Movements arising from cash flow	**(365)**	(376)
Investment appreciation, exchange translation and other items	**163**	(108)
Transfer to retained profit in respect of shares issued in lieu of cash dividends	**116**	27
Portfolio investments net of financing at beginning of year	**(1,998)**	(1,541)
Portfolio investments net of financing at end of year	**(2,084)**	(1,998)
Represented by:		
Investments (including short-term deposits)	**3,402**	2,271
Cash at bank and in hand	**431**	410
Borrowings	**(4,399)**	(4,185)
Share capital and share premium	**(1,677)**	(653)
Cumulative charge to Group profit and loss account reserve in respect of shares issued to qualifying employee share ownership trust	**159**	159
	(2,084)	(1,998)

Reconciliation of Investments

	2004 £m	2003 £m
Shareholders' funds (as above)	**3,402**	2,271
Long-term business operations	**126,227**	117,913
Investments in participating interests	**26**	56
Total investments (per consolidated balance sheet)	**129,655**	120,240
Reconciliation of Cash		
Shareholders' funds (as above)	**431**	410
Long-term business operations	**984**	811
Total cash at bank and in hand (per consolidated balance sheet)	**1,415**	1,221
Reconciliation of Borrowings		
Shareholders' funds (as above)	**4,399**	4,185
Long-term business operations	**274**	260
Total borrowings (note 32)	**4,673**	4,445