

November 2003	1.72	1.67
December 2003	1.78	1.72
January 2004	1.85	1.79
February 2004	1.90	1.82
March 2004	1.87	1.79
April 2004	1.86	1.77

On May 14, 2004, the noon buying rate was £1.00 = \$1.76

## RISK FACTORS

Prudential's operating results, financial condition and trading price are affected by a number of factors including economic and market conditions, foreign currency exchange rate fluctuations, regulation, government policy and legislation, competition, credit ratings, and operational systems and processes.

### **Prudential's businesses are inherently subject to market fluctuations and general economic conditions.**

Prudential's businesses are inherently subject to market fluctuations and general economic conditions. In the UK, this is largely because Prudential's shareholders' profit is related to bonuses for policyholders declared on its with-profits products, which are broadly based on historic and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns.

In the US, fluctuations in prevailing interest rates can affect results from Jackson National Life which is predominantly a spread-based business with the majority of its assets invested in fixed income securities. In particular, fixed annuities and stable value products in Jackson National Life expose the Group to the risk that changes in interest rates which are not fully reflected in the interest rates credited to customers will reduce spread. The spread is the difference between the amounts that Jackson National Life is required to pay under the contracts, and the rate of return it is able to earn on its general account investments to support the obligations under the contract. Declines in spread from these products or other spread businesses that Jackson National Life conducts could have a material impact on its businesses or results of operations.

Similar factors can also impact on Prudential's operations in Asia.

In all markets in which Prudential operates, its businesses are susceptible to general economic conditions, which can change the level of demand for Prudential's products. Past uncertain trends in international economic and investment climates which have adversely affected Prudential's business and profitability could be repeated. This adverse effect would be felt principally through reduced investment returns and credit defaults in fixed interest corporate bonds, and may continue to affect the business unless conditions improve. In addition, falling investment returns could impair Prudential's operational capability, including its ability to write significant volumes of new business.

See Item 4, "Information on the Company—Business of Prudential—Investments" for a description of Prudential's invested assets, investment strategies and investment yields. See also Item 5, "Operating and Financial Review and Prospects—Factors Affecting Results of Operations—General Economic and Market Conditions".

### **Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its business.**

Due to the geographical diversity of Prudential's businesses, it is subject to the risk of exchange rate fluctuations. Prudential's international operations in the US, Asia and Europe, which represent a significant proportion of operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements upon translation of results into pounds sterling. The currency exposure relating to the translation of reported earnings is not separately managed. Consequently, this could impact on the Group's gearing ratios (defined as debt over debt plus shareholders' funds). The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within the consolidated statement of total recognized gains and losses.

Of core structural borrowings at December 31, 2003 of £2,567 million, £827 million was denominated in US dollars, partially to hedge the currency exposure arising from Prudential's investment in its US operations. Consequently this could impact on the Group's gearing ratios. In 2003, a loss of £253 million net of related tax was recorded in the consolidated statement of total recognized gains and losses. This loss primarily arises upon translation into pounds sterling of the investments in Prudential's US and Asian operations, but is after offset of exchange gains of £87 million on the carrying value of the US dollar denominated borrowings, reflecting movements in the US dollar to pounds sterling exchange rate during 2003. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk".

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

Changes in government policy, legislation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates may adversely affect Prudential's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. These changes include possible changes in government pension arrangements and policies, the regulation of selling practices and solvency requirements. For instance, in the UK the Financial Services Authority's (FSA) proposals on reforming the UK polarization regime and consultation paper on treating with-profits policyholders fairly and the HM Treasury report on medium and long-term retail savings could have a significant effect on types of products sold by Prudential, how its products are priced, distributed and sold and on shareholders' return on with-profits business.

Similar changes in regulation in other jurisdictions could also have an impact elsewhere in the Group.

The EU Insurance Groups Directive, which was implemented in the UK in 2001, together with the Financial Conglomerates Directive, which will be implemented by 2005, will require European financial services groups to demonstrate net aggregate surplus capital in excess of solvency requirements at the Group level in respect of shareholder-owned entities. The EU is also currently reviewing future solvency requirements (the Solvency II review). The manner of the implementation of these directives is likely to lead to Prudential being required to maintain a somewhat higher level of capital at the Group level than currently necessary in respect of its businesses, or alternatively, to constrain the growth of those businesses, or to take other appropriate action. In addition, an inconsistent application of these directives by regulators in different EU member states may place Prudential at a competitive disadvantage to other European financial services groups.

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

See Item 5, "Operating and Financial Review and Prospects—Factors Affecting Results of Operations—Government Policy and Legislation" and Item 4, "Information on the Company—Supervision and Regulation of Prudential".

**The resolution of several issues affecting the financial services industry, including in the UK the requirement to provide redress to certain past purchasers of pension and mortgage endowment policies and regulatory reviews on products sold and industry practices, could have a negative impact on Prudential's reported results or on its relations with current and potential customers.**

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally. This could be a review of business sold in the past under previously acceptable market practices at the time. Pending legal and regulatory actions include proceedings relating to aspects of Prudential's business and operations and which are typical of the business it operates, including in the latter case businesses it has closed. Although Prudential believes it has adequately reserved in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such reserves are sufficient. It is possible that Prudential's future performance could be affected by an unfavorable outcome in these matters.

**Prudential's businesses are conducted in highly competitive environments and Prudential's continued profitability depends on its management's ability to respond to these pressures.**

The markets for UK, US and Asian financial services are highly competitive, with several factors affecting Prudential's ability to sell its products, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance and historical bonus levels. In some of its markets Prudential faces competitors who are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates or claims-paying ratios.

Within the UK, Prudential's principal competitors in the life market include many of the major stock and mutual retail financial services companies including, in particular, Aviva, Legal and General, Scottish Widows and Standard Life. In 2003 Prudential had a 48% market share of group additional voluntary contributions, 23% of the individual annuity market and in the fourth quarter had a 51% share of the with-profits bond market sold through IFAs.

Jackson National Life's competitors in the US include major stock and mutual insurance companies, mutual fund organizations, banks and other financial services companies. Jackson National Life's principal life insurance company competitors in the US include AXA Financial, Inc., Lincoln National Corporation, Transamerica Corporation, Nationwide Financial Services, Inc., SunAmerica, Inc. and Hartford Life, Inc. At December 31, 2003 in the United States Jackson National Life was the twelfth-largest life insurance company in terms of General Account assets, the fifth-largest provider of individual fixed annuities in terms of sales and the fifteenth largest provider of variable annuities in terms of sales.

Within Asia, Prudential's main regional competitors are international financial companies, including AIG, Allianz, ING and Manulife. At December 31, 2003 by new business premiums Prudential had top five new business market positions in eight life markets (Singapore, Malaysia, Hong Kong, India, Vietnam, the Philippines, Guangzhou (China) and Indonesia), two mutual fund markets (Taiwan and India) and Hong Kong's Mandatory Provident Fund market.

Prudential believes competition will intensify across all regions in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors. Prudential's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures. See Item 4, "Information on the Company—Business of Prudential—Competition".

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

Prudential's financial strength and credit ratings, which are intended to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in most of Prudential's products, and as a result its competitiveness. Downgrades in Prudential's ratings could have an adverse effect on its ability to market products and retain current policyholders. In addition, the interest rates Prudential pays on its borrowings are affected by its debt credit ratings, which are in place to measure Prudential's ability to pay its contractual obligations. On December 20, 2002, Moody's downgraded the financial strength rating of Prudential Assurance's long-term fund from Aaa (on review for possible downgrade) to Aa1 (stable outlook). On January 29, 2003, Standard & Poor's downgraded the financial strength rating of Prudential Assurance's long-term fund from AAA (negative outlook) to AA+ (stable outlook). AM Best Co rates the strength of Prudential Assurance's long term fund as A++. Prudential believes the downgrades that it, and the rest of the UK insurance industry, experienced have not to date had a discernible impact on its performance. The ratings from Standard & Poor's and Moody's for Prudential Assurance's long-term fund represent the second highest ratings in their respective rating categories, and the rating from AM Best Co represents the third highest rating in their rating category.

Prudential's long-term senior debt is rated as A2 (stable outlook) by Moody's, AA- (negative outlook) by Standard & Poor's and aa- by AM Best Co. The rating from Moody's represents their third highest category out of 9, the rating from Standard & Poor's represents the second highest category out of 10 and the rating from AM Best Co represents the second highest category out of 10. Prudential's short-term debt is rated as P-1 by Moody's and A1+ by Standard & Poor's. These ratings represent the highest rating category out of 4 and out of 6 categories for each rating agency, respectively.

**Adverse experience in the operational risks inherent in Prudential's business could have a negative impact on its results of operations.**

Operational risks are present in all of Prudential's businesses, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. Prudential's business is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. In addition, Prudential manages several outsourced operations which include certain UK processing and information technology functions. In turn, Prudential is reliant upon the operational processing performance of its outsourcing partners.

Further, because of the long-term nature of much of Prudential's business, accurate records have to be maintained for significant periods. Prudential's systems and processes are designed to ensure that the operational risks associated with its activities are appropriately controlled, but any weakness in the systems could have a negative impact on its results of operations during the effective period. Prudential has not experienced or identified any operational risks in its systems or processes during the financial periods covered by this annual report or subsequently which have caused, or are expected to cause, a significant negative impact on its results of operations. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk—Risk Management of Prudential—Operational, Compliance and Fiscal Risk" and Item 4, "Business of Prudential—UK and Europe Business—Compliance".

**Changes in mortality experienced by Prudential's UK pension annuity policyholders could significantly affect Prudential's results of operations.**

Prudential is a major participant in the UK pensions annuity market. In exchange for a premium equal to the capital value of their accumulated pension fund, each pension annuity policyholder receives a guaranteed payment, usually monthly, for as long as they are alive. For a smaller monthly payment, certain annuity contracts extend the right to the payment to

surviving spouses. As part of its pension annuity pricing and reserving policy Prudential assumes that current rates of mortality continuously improve over time. Annuity mortality assumptions have been revised in 2003 to assume future improvements in mortality for males and females at levels projected on the Continuous Mortality Investigations medium cohort table as published by the Institute and Faculty of Actuaries. This corresponds to annual improvement rates at the current time of 2.6% and 3.5% respectively for 65 and 70 year olds and 2.4% and 1.9% for the same ages in 5 years time. In addition and for the purposes of prudent statutory reserves these improvement rates were for male lives subject to a minimum of 2% a year. If mortality improvement rates significantly exceed the improvement assumed, Prudential's results of operations could be adversely affected.

**As a Holding Company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments.**

Prudential's insurance and investment management operations are generally conducted through direct and indirect subsidiaries. As a holding company, Prudential's principal sources of funds are dividends from subsidiaries, shareholder backed funds, the shareholder transfer from Prudential's long-term funds and any amounts that may be raised through the issuance of debt and commercial paper.

Certain of the subsidiaries have regulatory restrictions that can limit the payment of dividends, which can limit the Group's ability to pay dividends to shareholders.

#### **FORWARD-LOOKING STATEMENTS**

This annual report may contain certain "forward-looking statements" with respect to certain of Prudential's plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements containing the words "believes", "intends", "expects", "plans", "seeks" and "anticipates", and words of similar meaning, are forward-looking. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond Prudential's control including among other things, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, the impact of competition, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; and the impact of changes in capital, solvency or accounting standards, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate. This may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits, together with other factors discussed in "Risk Factors". As a result, Prudential's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in Prudential's forward-looking statements contained in this document or any other forward-looking statement it may make.

In particular, the following are forward-looking in nature:

- certain statements in Item 4, "Information on the Company" with regard to strategy and management objectives, trends in market shares, prices, market standing and product volumes and the effects of changes or prospective changes in regulation, and
- certain statements in Item 5, "Operating and Financial Review and Prospects" with regard to trends in results, prices, volumes, operations, margins, overall market trends, risk management and exchange rates and with regard to the effects of changes or prospective changes in regulation.

Prudential may also make or disclose written and/or oral forward-looking statements in reports filed or furnished to the US Securities and Exchange Commission, Prudential's annual report and accounts to shareholders, proxy statements, offering circulars, registration statements and prospectuses, press releases and other written materials and in oral statements made by directors, officers or employees of Prudential to third parties, including financial analysts. Prudential undertakes no obligation to update any of the forward-looking statements contained in this annual report or any other forward-looking statements it may make.

#### **Item 4. Information on the Company**

##### **BUSINESS OF PRUDENTIAL**

###### **Overview**

Prudential is a leading international financial services group, providing retail financial services and fund management in its chosen markets: the United Kingdom, the United States, Asia and continental Europe. At December 31, 2003, Prudential was one of the 30 largest public companies in the United Kingdom in terms of market capitalization on the London Stock Exchange. Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

Prudential has been writing life insurance in the United Kingdom for over 150 years and has had the largest long-term fund in the United Kingdom for over a century. Prudential began writing property and casualty insurance in 1915, and expanded its business into British Commonwealth countries, including Singapore and Malaysia, in the 1920s and 1930s. In 1986, Prudential acquired Jackson National Life Insurance Company, a US insurance company writing life and fixed annuity business. A group strategy review in the early 1990s identified significant opportunities for Prudential in the Asian life sector and Prudential Corporation Asia (referred to as PCA) was established in 1994 to develop a material and profitable Asian business. In 1998, Prudential launched Egg, now a leading e-commerce retail financial services provider, and in 1999, Prudential acquired M&G, a leading UK fund manager. In June 2000, Prudential completed its listing on the New York Stock Exchange and completed an initial public offering of Egg plc on the London Stock Exchange. In January 2002, Prudential completed the transfer of its personal lines property and casualty insurance business to Winterthur Insurance and the Churchill Group, its UK subsidiary, for consideration of £353 million.

In the United Kingdom, Prudential offers a range of retail financial products and services, including long-term insurance and asset accumulation products (life insurance, pensions and pension annuities), retail investment and unit trust products, fund management services and banking products. Prudential primarily distributes these products through independent financial advisers, referred to as IFAs, bank branches, and direct marketing, by telephone, mail and the internet.

At December 31, 2003, in the United Kingdom, Prudential was:

- the second-largest life insurance group in terms of market capitalization,
- the proprietor of the largest long-term fund of investment assets supporting long-term insurance products,
- the third largest retail fund manager in terms of funds under management,