

C Balance sheet notes

C1 Analysis of Group statement of financial position by segment

To explain the assets, liabilities and capital of the Group's businesses more comprehensively, it is appropriate to provide analyses of the Group's statement of financial position by operating segment and type of business.

By operating segment	30 Jun 2017 £m										30 Jun 2016 £m	31 Dec 2016 £m
	Insurance operations			Asset management				Unallocated to a segment (central operations)	Elimination of intra-group debtors and creditors	Group total	Group total	Group total
	Asia C2.1	US C2.2	UK C2.3	M&G	Prudential Capital	US	Eastspring Investments					
Assets												
Goodwill ^{C5(a)}	245	–	26	1,153	–	16	61	–	–	1,501	1,677	1,628
Deferred acquisition costs and other intangible assets ^{C5(b)}	2,340	8,187	168	6	–	5	4	47	–	10,757	9,594	10,807
Property, plant and equipment ^{note (i)}	119	224	344	4	–	8	3	25	–	727	1,214	743
Reinsurers' share of insurance contract liabilities	1,680	6,740	2,560	–	–	–	–	–	(1,271)	9,709	9,470	10,051
Deferred tax assets ^{C7}	85	3,678	127	20	7	130	8	50	–	4,105	3,771	4,315
Current tax recoverable	30	348	311	–	5	6	–	70	(70)	700	554	440
Accrued investment income	565	493	1,650	7	23	76	32	41	–	2,887	2,764	3,153
Other debtors	2,598	260	2,796	1,000	758	73	62	5,418	(9,548)	3,417	3,505	3,019
Investment properties	5	6	15,207	–	–	–	–	–	–	15,218	13,940	14,646
Investment in joint ventures and associates accounted for using the equity method	714	–	405	39	–	–	135	–	–	1,293	1,135	1,273
Loans ^{C3.3}	1,307	9,497	5,784	–	364	–	–	–	–	16,952	14,215	15,173
Equity securities and portfolio holdings in unit trusts	26,753	125,059	58,398	111	–	–	19	97	–	210,437	176,037	198,552
Debt securities ^{C3.2}	39,061	38,029	91,302	–	2,381	–	–	20	–	170,793	168,367	170,458
Derivative assets	102	906	2,676	–	101	–	–	4	–	3,789	5,495	3,936
Other investments	–	932	4,614	16	–	4	–	–	–	5,566	4,845	5,465
Deposits	1,243	–	11,843	–	–	18	44	205	–	13,353	14,181	12,185
Assets held for sale	–	–	33	–	–	–	–	–	–	33	30	4,589
Cash and cash equivalents	1,786	1,194	4,565	350	1,451	276	156	115	–	9,893	8,530	10,065
Total assets	78,633	195,553	202,809	2,706	5,090	612	524	6,092	(10,889)	481,130	439,324	470,498

By operating segment	30 Jun 2017 £m										30 Jun 2016 £m	31 Dec 2016 £m
	Insurance operations			Asset management				Unallocated to a segment (central operations)	Elimination of intra-group debtors and creditors	Group total	Group total	Group total
	Asia C2.1	US C2.2	UK C2.3	M&G	Prudential Capital	US	Eastspring Investments					
Total equity	5,181	5,011	6,227	1,868	61	202	382	(3,482)	–	15,450	14,606	14,667
Liabilities												
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) ^{C4.1(a)}	59,619	177,779	162,853	–	–	–	–	–	(1,271)	398,980	362,510	388,996
Unallocated surplus of with-profits funds ^{C4.1(a)}	3,003	–	12,087	–	–	–	–	–	–	15,090	13,597	14,317
Core structural borrowings of shareholder-financed operations ^{C6.1}	–	192	–	–	275	–	–	6,147	–	6,614	5,966	6,798
Operational borrowings attributable to shareholder-financed operations ^{C6.2(a)}	20	453	147	52	–	–	–	1,424	–	2,096	2,798	2,317
Borrowings attributable to with-profits operations ^{C6.2(b)}	20	–	3,316	–	–	–	–	–	–	3,336	1,427	1,349
Obligations under funding, securities lending and sale and repurchase agreements	–	4,518	1,890	–	–	–	–	–	–	6,408	4,963	5,031
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	3,541	–	5,036	–	–	–	–	–	–	8,577	8,770	8,687
Deferred tax liabilities ^{C7}	1,021	2,981	1,646	21	–	2	1	11	–	5,683	5,397	5,370
Current tax liabilities	162	58	451	37	20	2	13	70	(70)	743	566	649
Accruals, deferred income and other liabilities ^{note (iv)}	5,804	4,517	7,035	547	4,208	406	75	1,480	(9,548)	14,524	12,915	13,825
Provisions	138	1	350	181	–	–	53	36	–	759	467	947
Derivative liabilities	124	43	1,771	–	526	–	–	406	–	2,870	5,342	3,252
Liabilities held for sale	–	–	–	–	–	–	–	–	–	–	–	4,293
Total liabilities	73,452	190,542	196,582	838	5,029	410	142	9,574	(10,889)	465,680	424,718	455,831
Total equity and liabilities	78,633	195,553	202,809	2,706	5,090	612	524	6,092	(10,889)	481,130	439,324	470,498

Notes

- (i) £409 million (30 June 2016: £910 million; 31 December 2016: £413 million) of the property, plant and equipment of £727 million (30 June 2016: £1,214 million; 31 December 2016: £743 million) was held by the Group's with-profits operations, primarily by the consolidated subsidiaries for venture funds and other investment purposes of the PAC with-profits fund. The Group made additions to property, plant and equipment of £120 million during the period (30 June 2016: £128 million; 31 December 2016: £348 million).
- (ii) Reinsurers' share of contract liabilities relate primarily to the reinsurance ceded in respect of the acquired REALIC business by the Group's US insurance operations.
- (iii) Within other debtors are premiums receivable of £432 million (30 June 2016: £467 million; 31 December 2016: £498 million) of which 77 per cent are due within one year. The remaining 23 per cent is due after one year.
- (iv) Within 'Accruals, deferred income and other liabilities' of £14,524 million (30 June 2016: £12,915 million; 31 December 2016: £13,825 million) is an amount of £8,575 million (30 June 2016: £7,506 million; 31 December 2016: £9,873 million) that is due within one year.

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C2 Analysis of segment statement of financial position by business type

To show the statement of financial position by reference to the differing degrees of policyholder and shareholder economic interest of the different types of business, the analysis below is structured to show the assets and liabilities of each segment by business type.

C2.1 Asia insurance operations

		2017 £m				2016 £m	
	Note	With-profits business	Unit-linked assets and liabilities	Other business	30 Jun Total	30 Jun Total	31 Dec Total
Assets							
Goodwill		–	–	245	245	258	245
Deferred acquisition costs and other intangible assets		31	–	2,309	2,340	2,356	2,316
Property, plant and equipment		82	–	37	119	88	121
Reinsurers' share of insurance contract liabilities		50	–	1,630	1,680	1,564	1,539
Deferred tax assets		–	–	85	85	92	98
Current tax recoverable		–	–	30	30	38	29
Accrued investment income		253	60	252	565	570	521
Other debtors		1,847	189	562	2,598	3,229	2,633
Investment properties		–	–	5	5	5	5
Investment in joint ventures and associates accounted for using the equity method		–	–	714	714	525	688
Loans	C3.3	702	–	605	1,307	1,278	1,303
Equity securities and portfolio holdings in unit trusts		12,821	12,397	1,535	26,753	22,631	23,581
Debt securities	C3.2	23,398	3,442	12,221	39,061	35,519	36,546
Derivative assets		58	3	41	102	79	47
Deposits		307	393	543	1,243	912	1,379
Assets held for sale		–	–	–	–	–	3,863
Cash and cash equivalents		733	234	819	1,786	2,010	1,995
Total assets		40,282	16,718	21,633	78,633	71,154	76,909
Total equity		–	–	5,181	5,181	4,874	4,993
Liabilities							
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(b)	31,549	15,326	12,744	59,619	53,437	55,018
Unallocated surplus of with-profits funds	C4.1(b)	3,003	–	–	3,003	2,351	2,667
Operational borrowings attributable to shareholder-financed operations		–	13	7	20	11	19
Borrowings attributable to with-profits operations		20	–	–	20	6	4
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		2,114	1,201	226	3,541	3,379	3,093
Deferred tax liabilities		705	38	278	1,021	905	935
Current tax liabilities		64	–	98	162	109	113
Accruals, deferred income and other liabilities		2,667	138	2,999	5,804	5,838	5,887
Provisions		48	–	90	138	115	157
Derivative liabilities		112	2	10	124	129	265
Liabilities held for sale		–	–	–	–	–	3,758
Total liabilities		40,282	16,718	16,452	73,452	66,280	71,916
Total equity and liabilities		40,282	16,718	21,633	78,633	71,154	76,909

Note

The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore operations. Assets and liabilities of other participating businesses are included in the column for 'Other business'.

C2.2 US insurance operations

		2017 £m			2016 £m	
	Note	Variable annuity separate account assets and liabilities	Fixed annuity, GIC and other business	30 Jun Total	30 Jun Total	31 Dec Total
Assets						
Deferred acquisition costs and other intangible assets		–	8,187	8,187	7,081	8,323
Property, plant and equipment		–	224	224	213	237
Reinsurers' share of insurance contract liabilities		–	6,740	6,740	6,859	7,224
Deferred tax assets		–	3,678	3,678	3,369	3,861
Current tax recoverable		–	348	348	254	95
Accrued investment income		–	493	493	520	549
Other debtors		–	260	260	18	295
Investment properties		–	6	6	5	6
Loans	C3.3	–	9,497	9,497	8,504	9,735
Equity securities and portfolio holdings in unit trusts		124,735	324	125,059	104,124	120,747
Debt securities	C3.2	–	38,029	38,029	41,143	40,745
Derivative assets		–	906	906	1,608	834
Other investments		–	932	932	895	987
Cash and cash equivalents		–	1,194	1,194	1,056	1,054
Total assets		124,735	70,818	195,553	175,649	194,692
Total equity		–	5,011	5,011	5,056	5,204
Liabilities						
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(c)	124,735	53,044	177,779	159,155	177,626
Core structural borrowings of shareholder-financed operations		–	192	192	186	202
Operational borrowings attributable to shareholder-financed operations		–	453	453	70	480
Obligations under funding, securities lending and sale and repurchase agreements		–	4,518	4,518	3,144	3,534
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		–	–	–	23	–
Deferred tax liabilities		–	2,981	2,981	3,204	2,831
Current tax liabilities		–	58	58	–	–
Accruals, deferred income and other liabilities		–	4,517	4,517	4,385	4,749
Provisions		–	1	1	5	2
Derivative liabilities		–	43	43	421	64
Total liabilities		124,735	65,807	190,542	170,593	189,488
Total equity and liabilities		124,735	70,818	195,553	175,649	194,692

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C2 Analysis of segment statement of financial position by business type continued

C2.3 UK insurance operations

		2017 £m				2016 £m	
		Other funds and subsidiaries					
By operating segment	Note	With-profits sub-funds note (i)	Unit-linked assets and liabilities	Annuity and other long-term business	Total	30 Jun Total	31 Dec Total
Assets							
Goodwill		26	–	–	–	26	189
Deferred acquisition costs and other intangible assets		82	–	86	86	168	107
Property, plant and equipment		327	–	17	17	344	343
Reinsurers' share of insurance contract liabilities		1,308	135	1,117	1,252	2,560	2,590
Deferred tax assets		73	–	54	54	127	146
Current tax recoverable		179	–	132	132	311	283
Accrued investment income		1,040	93	517	610	1,650	1,915
Other debtors		1,895	224	677	901	2,796	2,447
Investment properties		12,962	650	1,595	2,245	15,207	14,635
Investment in joint ventures and associates accounted for using the equity method		405	–	–	–	405	409
Loans	C3.3	4,036	–	1,748	1,748	5,784	3,572
Equity securities and portfolio holdings in unit trusts		43,023	15,339	36	15,375	58,398	54,037
Debt securities	C3.2	49,165	6,743	35,394	42,137	91,302	90,796
Derivative assets		2,183	3	490	493	2,676	2,927
Other investments		4,608	5	1	6	4,614	4,449
Deposits		9,542	968	1,333	2,301	11,843	10,705
Assets held for sale ^{note (ii)}		33	–	–	–	33	726
Cash and cash equivalents		3,230	762	573	1,335	4,565	4,703
Total assets		134,117	24,922	43,770	68,692	202,809	188,617

By operating segment	Note	2017 £m				2016 £m		
		With-profits sub-funds note (i)	Other funds and subsidiaries		Total	30 Jun Total	30 Jun Total	31 Dec Total
			Unit-linked assets and liabilities	Annuity and other long-term business				
Total equity		–	–	6,227	6,227	6,227	6,163	5,999
Liabilities								
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(d)	106,362	22,917	33,574	56,491	162,853	151,233	157,654
Unallocated surplus of with-profits funds	C4.1(d)	12,087	–	–	–	12,087	11,246	11,650
Operational borrowings attributable to shareholder-financed operations		–	4	143	147	147	163	167
Borrowings attributable to with-profits operations		3,316	–	–	–	3,316	1,421	1,345
Obligations under funding, securities lending and sale and repurchase agreements		1,216	–	674	674	1,890	1,619	1,497
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		3,152	1,856	28	1,884	5,036	5,368	5,594
Deferred tax liabilities		1,354	–	292	292	1,646	1,253	1,577
Current tax liabilities		246	68	137	205	451	363	447
Accruals, deferred income and other liabilities		5,604	76	1,355	1,431	7,035	5,896	6,176
Provisions		62	–	288	288	350	156	442
Derivative liabilities		718	1	1,052	1,053	1,771	3,736	1,860
Liabilities held for sale ^{note (ii)}		–	–	–	–	–	–	535
Total liabilities		134,117	24,922	37,543	62,465	196,582	182,454	188,944
Total equity and liabilities		134,117	24,922	43,770	68,692	202,809	188,617	194,943

Notes

- (i) Includes the Scottish Amicable Insurance Fund which, at 30 June 2017, has total assets and liabilities of £5,943 million (30 June 2016: £6,282 million; 31 December 2016: £6,101 million). The PAC with-profits sub-fund mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The PAC with-profits fund includes £10.9 billion (30 June 2016: £11.3 billion; 31 December 2016: £11.2 billion) of non-profit annuities liabilities.
- (ii) The assets and liabilities held for sale for the UK insurance operations comprise the investment properties and consolidated private equity investments of the PAC with-profits fund, for which the sales had been agreed but not yet completed at the period end.

C3 Assets and liabilities – classification and measurement

C3.1 Group assets and liabilities – measurement

(a) Determination of fair value

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments, or by using quotations from independent third parties, such as brokers and pricing services, or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm's length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third parties, or valued internally using standard market practices.

Other than the loans which have been designated at fair value through profit or loss, the loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The discount rate used is updated for the market rate of interest where applicable.

The fair value of investment properties is based on market values as assessed by professionally qualified external valuers or by the Group's qualified surveyors.

The fair value of financial liabilities (other than derivative financial instruments) and borrowings that are carried at fair value through profit or loss is determined using discounted cash flows of the amounts expected to be paid.

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C3 Assets and liabilities – classification and measurement continued

C3.1 Group assets and liabilities – measurement continued

(b) Fair value hierarchy of financial instruments measured at fair value on recurring basis

Assets and liabilities carried at fair value on the statement of financial position

The table below shows the financial instruments carried at fair value analysed by the level of the IFRS 13 'Fair Value Measurement' defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

Financial instruments at fair value

	30 Jun 2017 £m			
	Level 1	Level 2	Level 3	
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	Total
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	–	–	1,906	1,906
Equity securities and portfolio holdings in unit trusts	51,136	4,282	426	55,844
Debt securities	28,122	44,145	296	72,563
Other investments (including derivative assets)	73	3,310	3,464	6,847
Derivative liabilities	(79)	(752)	–	(831)
Total financial investments, net of derivative liabilities	79,252	50,985	6,092	136,329
Percentage of total	58%	38%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	152,050	399	23	152,472
Debt securities	5,243	4,943	–	10,186
Other investments (including derivative assets)	4	3	4	11
Derivative liabilities	(2)	–	–	(2)
Total financial investments, net of derivative liabilities	157,295	5,345	27	162,667
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	–	309	2,594	2,903
Equity securities and portfolio holdings in unit trusts	2,104	7	10	2,121
Debt securities	21,525	66,233	286	88,044
Other investments (including derivative assets)	–	1,501	996	2,497
Derivative liabilities	(26)	(1,551)	(460)	(2,037)
Total financial investments, net of derivative liabilities	23,603	66,499	3,426	93,528
Percentage of total	25%	71%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	309	4,500	4,809
Equity securities and portfolio holdings in unit trusts	205,290	4,688	459	210,437
Debt securities	54,890	115,321	582	170,793
Other investments (including derivative assets)	77	4,814	4,464	9,355
Derivative liabilities	(107)	(2,303)	(460)	(2,870)
Total financial investments, net of derivative liabilities	260,150	122,829	9,545	392,524
Investment contract liabilities without discretionary participation features held at fair value	–	(17,166)	–	(17,166)
Borrowings attributable to with-profits operations	–	–	(1,816)	(1,816)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(5,719)	(2,421)	(437)	(8,577)
Other financial liabilities held at fair value	–	(394)	(2,766)	(3,160)
Total financial instruments at fair value	254,431	102,848	4,526	361,805
Percentage of total	70%	29%	1%	100%

	30 Jun 2016 £m			
	Level 1	Level 2	Level 3	
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	Total
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Equity securities and portfolio holdings in unit trusts	38,596	3,969	630	43,195
Debt securities	24,430	42,741	662	67,833
Other investments (including derivative assets)	103	3,157	3,674	6,934
Derivative liabilities	(192)	(2,536)	–	(2,728)
Total financial investments, net of derivative liabilities	62,937	47,331	4,966	115,234
Percentage of total	55%	41%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	130,977	401	27	131,405
Debt securities	4,956	5,059	–	10,015
Other investments (including derivative assets)	11	38	5	54
Derivative liabilities	(19)	(51)	–	(70)
Total financial investments, net of derivative liabilities	135,925	5,447	32	141,404
Percentage of total	96%	4%	0%	100%
Non-linked shareholder-backed				
Loans	–	259	2,448	2,707
Equity securities and portfolio holdings in unit trusts	1,402	1	34	1,437
Debt securities	23,379	66,823	317	90,519
Other investments (including derivative assets)	–	2,369	983	3,352
Derivative liabilities	–	(2,064)	(480)	(2,544)
Total financial investments, net of derivative liabilities	24,781	67,388	3,302	95,471
Percentage of total	26%	71%	3%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	259	2,448	2,707
Equity securities and portfolio holdings in unit trusts	170,975	4,371	691	176,037
Debt securities	52,765	114,623	979	168,367
Other investments (including derivative assets)	114	5,564	4,662	10,340
Derivative liabilities	(211)	(4,651)	(480)	(5,342)
Total financial investments, net of derivative liabilities	223,643	120,166	8,300	352,109
Investment contract liabilities without discretionary participation features held at fair value	–	(16,178)	–	(16,178)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(5,275)	(2,427)	(1,068)	(8,770)
Other financial liabilities held at fair value	–	(375)	(2,616)	(2,991)
Total financial instruments at fair value	218,368	101,186	4,616	324,170
Percentage of total	67%	31%	2%	100%

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C3 Assets and liabilities – classification and measurement continued

C3.1 Group assets and liabilities – measurement continued

	31 Dec 2016 £m			
	Level 1	Level 2	Level 3	
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	Total
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	–	–	27	27
Equity securities and portfolio holdings in unit trusts	45,181	3,669	690	49,540
Debt securities	26,227	43,880	690	70,797
Other investments (including derivative assets)	58	3,357	3,443	6,858
Derivative liabilities	(51)	(1,025)	–	(1,076)
Total financial investments, net of derivative liabilities	71,415	49,881	4,850	126,146
Percentage of total	56%	40%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	146,637	374	22	147,033
Debt securities	5,136	4,462	–	9,598
Other investments (including derivative assets)	6	8	5	19
Derivative liabilities	(4)	(24)	–	(28)
Total financial investments, net of derivative liabilities	151,775	4,820	27	156,622
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	–	276	2,672	2,948
Equity securities and portfolio holdings in unit trusts	1,966	3	10	1,979
Debt securities	21,896	67,915	252	90,063
Other investments (including derivative assets)	–	1,492	1,032	2,524
Derivative liabilities	(9)	(1,623)	(516)	(2,148)
Total financial investments, net of derivative liabilities	23,853	68,063	3,450	95,366
Percentage of total	25%	71%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	276	2,699	2,975
Equity securities and portfolio holdings in unit trusts	193,784	4,046	722	198,552
Debt securities	53,259	116,257	942	170,458
Other investments (including derivative assets)	64	4,857	4,480	9,401
Derivative liabilities	(64)	(2,672)	(516)	(3,252)
Total financial investments, net of derivative liabilities	247,043	122,764	8,327	378,134
Investment contract liabilities without discretionary participation features held at fair value	–	(16,425)	–	(16,425)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(4,217)	(3,587)	(883)	(8,687)
Other financial liabilities held at fair value	–	(385)	(2,851)	(3,236)
Total financial instruments at fair value	242,826	102,367	4,593	349,786
Percentage of total	70%	29%	1%	100%

All assets and liabilities held at fair value are classified as fair value through profit or loss, except for £37,936 million (30 June 2016: £41,045 million; 31 December 2016: £40,645 million) of debt securities classified as available-for-sale.

The Korea life business was classified as held for sale in the second half of 2016, with the sale completed in May 2017. Accordingly, the financial instruments shown above only included the assets and liabilities of Korea life business as at 30 June 2016 (prior to its classification as held for sale). The assets and liabilities held for sale on the consolidated statement of financial position at 31 December 2016 in respect of Korea life business included a net financial instruments balance of £3,200 million, primarily for equity securities and debt securities. Of this amount, £2,763 million was classified as level 1 and £437 million as level 2.

(c) Valuation approach for level 2 fair valued financial instruments

A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades. For further detail on the valuation approach for level 2 fair valued financial instruments please refer to note C3.1 of the Group's consolidated financial statements for the year ended 31 December 2016.

Of the total level 2 debt securities of £115,321 million at 30 June 2017 (30 June 2016: £114,623 million; 31 December 2016: £116,257 million), £13,596 million are valued internally (30 June 2016: £11,867 million; 31 December 2016: £12,708 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

(d) Fair value measurements for level 3 fair valued financial instruments

Reconciliation of movements in level 3 financial instruments measured at fair value

The following table reconciles the value of level 3 fair valued financial instruments at 1 January 2017 to that presented at 30 June 2017.

Total investment return recorded in the income statement represents interest and dividend income, realised gains and losses, unrealised gains and losses on the assets classified at fair value through profit and loss and foreign exchange movements on an individual entity's overseas investments.

Total gains and losses recorded in other comprehensive income includes unrealised gains and losses on debt securities held as available-for-sale within Jackson and foreign exchange movements arising from the retranslation of the Group's overseas subsidiaries and branches.

C Balance sheet notes

Continued

C3 Assets and liabilities – classification and measurement continued

C3.1 Group assets and liabilities – measurement continued

Half year 2017 £m										
	At 1 Jan 2017	Total gains (losses) in income statement	Total gains (losses) recorded in other compre- hensive income	Purchases	Sales	Settled	Issued	Transfers into level 3	Transfers out of level 3	At 30 Jun 2017
Loans	2,699	96	(132)	1,879	–	(70)	28	–	–	4,500
Equity securities and portfolio holdings in unit trusts	722	(17)	(2)	175	(418)	–	–	–	(1)	459
Debt securities	942	2	(11)	142	(471)	–	–	–	(22)	582
Other investments (including derivative assets)	4,480	84	(64)	191	(227)	–	–	–	–	4,464
Derivative liabilities	(516)	56	–	–	–	–	–	–	–	(460)
Total financial investments, net of derivative liabilities	8,327	221	(209)	2,387	(1,116)	(70)	28	–	(23)	9,545
Borrowings attributable to with-profits operations	–	2	–	–	–	–	(1,818)	–	–	(1,816)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(883)	(357)	–	–	(167)	1,017*	(47)	–	–	(437)
Other financial liabilities	(2,851)	(96)	141	–	(1)	73	(32)	–	–	(2,766)
Total financial instruments at fair value	4,593	(230)	(68)	2,387	(1,284)	1,020	(1,869)	–	(23)	4,526

Half year 2016 £m										
	At 1 Jan 2016	Total gains (losses) in income statement	Total gains (losses) recorded in other compre- hensive income	Purchases	Sales	Settled	Issued	Transfers into level 3	Transfers out of level 3	At 30 Jun 2016
Loans	2,183	79	227	–	–	(64)	23	–	–	2,448
Equity securities and portfolio holdings in unit trusts	607	(13)	11	81	(4)	–	–	9	–	691
Debt securities	778	66	7	120	(17)	–	–	30	(5)	979
Other investments (including derivative assets)	4,276	184	265	377	(473)	–	–	33	–	4,662
Derivative liabilities	(353)	(127)	–	–	–	–	–	–	–	(480)
Total financial investments, net of derivative liabilities	7,491	189	510	578	(494)	(64)	23	72	(5)	8,300
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(1,036)	24	(2)	–	1	62*	(117)	–	–	(1,068)
Other financial liabilities	(2,347)	(84)	(243)	–	–	99	(41)	–	–	(2,616)
Total financial instruments at fair value	4,108	129	265	578	(493)	97	(135)	72	(5)	4,616

Full year 2016 £m										
	At 1 Jan 2016	Total gains (losses) in income statement	Total gains (losses) recorded in other compre- hensive income	Purchases	Sales	Settled	Issued	Transfers into level 3	Transfers out of level 3	At 31 Dec 2016
Loans	2,183	2	427	–	–	(123)	210	–	–	2,699
Equity securities and portfolio holdings in unit trusts	607	59	(20)	153	(133)	(9)	–	65	–	722
Debt securities	778	85	11	185	(75)	(37)	–	–	(5)	942
Other investments (including derivative assets)	4,276	359	443	720	(1,002)	–	–	73	(389)	4,480
Derivative liabilities	(353)	(163)	–	–	–	–	–	–	–	(516)
Total financial investments, net of derivative liabilities	7,491	342	861	1,058	(1,210)	(169)	210	138	(394)	8,327
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(1,036)	(18)	(2)	–	24	271*	(122)	–	–	(883)
Other financial liabilities	(2,347)	(4)	(457)	–	–	259	(302)	–	–	(2,851)
Total financial instruments at fair value	4,108	320	402	1,058	(1,186)	361	(214)	138	(394)	4,593

* Includes distributions to third-party investors by subsidiaries held by the UK with-profits funds for investment purposes. These distributions vary period to period depending on the maturity of the subsidiaries and the gains realised by those entities in the period.

Of the total net gains and losses in the income statement of £(230) million (30 June 2016: £129 million; 31 December 2016: £320 million), £(234) million (30 June 2016: £92 million; 31 December 2016: £242 million) relates to net unrealised gains (losses) relating to financial instruments still held at the end of the period, which can be analysed as follows:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Equity securities	21	(14)	8
Debt securities	2	65	71
Other investments	42	149	182
Derivative liabilities	56	(127)	–
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	2	23	(18)
Other financial liabilities	(357)	(4)	(1)
Total	(234)	92	242

C Balance sheet notes

Continued

C3 Assets and liabilities – classification and measurement continued

C3.1 Group assets and liabilities – measurement continued

Valuation approach for level 3 fair valued financial instruments

Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions, eg market illiquidity. The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option-adjusted spread models and, if applicable, enterprise valuation. For further detail on the valuation approach for level 3 fair valued financial instruments, please refer to note C3.1 of the Group's consolidated financial statements for the year ended 31 December 2016.

At 30 June 2017, the Group held £4,526 million (30 June 2016: £4,616 million; 31 December 2016: £4,593 million) of net financial instruments at fair value within level 3. This represents 1 per cent (30 June 2016: 2 per cent; 31 December 2016: 1 per cent) of the total fair valued financial assets net of fair valued financial liabilities.

The net financial instruments at fair value within level 3 at 30 June 2017 include £1,906 million of loans and a corresponding £1,816 million of borrowings held by a subsidiary of the Group's UK with-profits fund, attaching to the acquisition of a portfolio of buy-to-let mortgage loans in half year 2017 financed largely by external third-party (non-recourse) borrowings (see note C3.3(c) for further details). The fair value of these loans and the related borrowings is determined by an external valuer using the income approach, with the most significant inputs into the valuation being non-observable assumptions on the future level of defaults and prepayments and their effect on cash flows. The discount rate applied is updated to reflect changes in the LIBOR swap rate. The Group's exposure is limited to the investment held by the UK with-profits fund, rather than to the individual loans and borrowings themselves. The fair value movements of these loans and borrowings have no effect on shareholders' profit and equity.

Included within these amounts were loans of £2,594 million at 30 June 2017 (30 June 2016: £2,448 million; 31 December 2016: £2,672 million), measured as the loan outstanding balance attached to REALIC and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,766 million at 30 June 2017 (30 June 2016: £2,616 million; 31 December 2016: £2,851 million) was also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

Excluding the loans and funds withheld liability under REALIC's reinsurance arrangements as described above, which amounted to a net liability of £(172) million (30 June 2016: £(168) million; 31 December 2016: £(179) million), the level 3 fair valued financial assets net of financial liabilities were £4,698 million (30 June 2016: £4,784 million; 31 December 2016: £4,772 million). Of this amount, a net liability of £(218) million (30 June 2016: net asset of £47 million; 31 December 2016: net asset of £72 million) was internally valued, representing 0.1 per cent of the total fair valued financial assets net of financial liabilities (30 June 2016: 0.0 per cent; 31 December 2016: 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net liabilities were:

- (a) Debt securities of £446 million (30 June 2016: £463 million; 31 December 2016: £422 million), which were either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured);
- (b) Private equity and venture investments of £176 million (30 June 2016: £1,038 million; 31 December 2016: £956 million) which were valued internally based on management information available for these investments. These investments, in the form of debt and equity securities, were principally held by consolidated investment funds which are managed on behalf of third parties;
- (c) Liabilities of £(437) million (30 June 2016: £(1,045) million; 31 December 2016: £(883) million) for the net asset value attributable to external unit holders in respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets;
- (d) Derivative liabilities of £(460) million (30 June 2016: £(480) million; 31 December 2016: £(516) million) which are valued internally using standard market practices but are subject to independent assessment against counterparties' valuations; and
- (e) Other sundry individual financial investments of £57 million (30 June 2016: £71 million; 31 December 2016: £93 million).

Of the internally valued net liability referred to above of £(218) million (30 June 2016: net asset of £47 million; 31 December 2016: net asset of £72 million):

- (a) A net liability of £(97) million (30 June 2016: net asset of £303 million; 31 December 2016: net asset of £315 million) was held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments; and
- (b) A net liability of £(121) million (30 June 2016: net liability of £(256) million; 31 December 2016: net liability of £(243) million) was held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally was varied downwards by 10 per cent, the change in valuation would be £12 million (30 June 2016: £26 million; 31 December 2016: £24 million), which would increase (reduce) shareholders' equity by this amount before tax. All this amount passes through the income statement substantially as part of short-term fluctuations in investment returns outside of operating profit.

(e) Transfers into and transfers out of levels

The Group's policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer.

During half year 2017, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to 2 of £119 million and transfers from level 2 to level 1 of £400 million. These transfers, which primarily relate to debt securities, arose to reflect the change in the observability of the inputs used in valuing these securities.

In addition, the transfers out of level 3 in half year 2017 were £23 million. These transfers were primarily between levels 3 and 2 for debt securities and other investments. There were no transfers into level 3 in the period.

(f) Valuation processes applied by the Group

The Group's valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by business unit committees as part of the Group's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions.

C3.2 Debt securities

This note provides analysis of the Group's debt securities, including asset-backed securities and sovereign debt securities.

(a) Credit rating

Debt securities are analysed below according to external credit ratings issued, with equivalent ratings issued by different ratings agencies grouped together. Standard and Poor's ratings have been used where available, if this isn't the case Moody's and then Fitch have been used as alternatives. In the table below, AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB- ratings. Financial assets which fall outside this range are classified as below BBB-. Debt securities with no external credit rating are classified as 'Other'.

30 Jun 2017 £m							
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	3,168	9,722	3,540	3,201	1,789	1,978	23,398
Unit-linked	501	129	526	1,502	323	461	3,442
Non-linked shareholder-backed	1,138	2,758	3,035	2,699	1,645	946	12,221
US							
Non-linked shareholder-backed	455	6,739	10,318	13,526	1,046	5,945	38,029
UK							
With-profits	5,965	9,872	10,827	12,577	3,481	6,443	49,165
Unit-linked	597	2,871	1,131	1,856	176	112	6,743
Non-linked shareholder-backed	4,481	10,313	10,396	4,036	388	5,780	35,394
Other operations	819	1,275	192	95	14	6	2,401
Total debt securities	17,124	43,679	39,965	39,492	8,862	21,671	170,793

C Balance sheet notes

Continued

C3 Assets and liabilities – classification and measurement continued

C3.2 Debt securities continued

30 Jun 2016 £m							
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	2,894	7,756	3,132	2,982	1,925	1,889	20,578
Unit-linked	420	467	508	1,285	247	500	3,427
Non-linked shareholder-backed	1,013	3,126	2,944	1,961	1,450	1,020	11,514
US							
Non-linked shareholder-backed	3,761	6,190	10,137	13,379	888	6,788	41,143
UK							
With-profits	4,979	9,416	10,318	13,091	2,972	6,479	47,255
Unit-linked	404	2,488	1,218	2,042	339	97	6,588
Non-linked shareholder-backed	4,190	11,399	9,741	4,571	416	4,954	35,271
Other operations	1,024	1,165	286	112	2	2	2,591
Total debt securities	18,685	42,007	38,284	39,423	8,239	21,729	168,367

31 Dec 2016 £m							
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	3,183	8,522	3,560	2,996	1,887	1,713	21,861
Unit-linked	448	112	525	1,321	494	421	3,321
Non-linked shareholder-backed	1,082	2,435	2,864	2,388	1,680	915	11,364
US							
Non-linked shareholder-backed	445	7,932	10,609	13,950	1,009	6,800	40,745
UK							
With-profits	5,740	9,746	10,679	12,798	3,289	6,684	48,936
Unit-linked	461	2,660	1,158	1,699	212	87	6,277
Non-linked shareholder-backed	4,238	10,371	10,558	4,515	397	5,504	35,583
Other operations	830	1,190	242	97	10	2	2,371
Total debt securities	16,427	42,968	40,195	39,764	8,978	22,126	170,458

The credit ratings, information or data contained in this report which are attributed and specifically provided by S&P, Moody's and Fitch Solutions and their respective affiliates and suppliers (Content Providers) is referred to here as the 'Content'. Reproduction of any Content in any form is prohibited except with the prior written permission of the relevant party. The Content Providers do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. The Content Providers expressly disclaim liability for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold any such investment or security, nor does it address the suitability of an investment or security and should not be relied on as investment advice.

Securities with credit ratings classified as 'Other' can be further analysed as follows:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Asia			
Non-linked shareholder-backed			
Internally rated			
Government bonds	40	207	63
Corporate bonds – rated as investment grade by local external ratings agencies	821	582	757
Other	85	231	95
Total Asia non-linked shareholder-backed	946	1,020	915

	2017 £m			2016 £m	
	Mortgage-backed securities	Other securities	30 Jun Total	30 Jun Total	31 Dec Total
US					
Implicit ratings of other US debt securities based on NAIC* valuations (see below)					
NAIC 1	1,926	2,018	3,944	4,776	4,759
NAIC 2	10	1,893	1,903	1,868	1,909
NAIC 3-6	7	91	98	144	132
Total US	1,943	4,002	5,945	6,788	6,800

* The Securities Valuation Office of the NAIC classifies debt securities into six quality categories ranging from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5 and securities in or near default are designated Class 6.

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
UK			
Internal ratings or unrated			
AAA to A-	7,494	6,584	6,939
BBB to B-	3,180	3,284	3,257
Below B- or unrated	1,661	1,662	2,079
Total UK	12,335	11,530	12,275

In addition to the debt securities shown above, the assets held for sale on the consolidated statement of financial position at 31 December 2016 in respect of Korea life business included a debt securities balance of £652 million.

C Balance sheet notes

Continued

C3 Assets and liabilities – classification and measurement continued

C3.2 Debt securities continued

(b) Additional analysis of US insurance operations debt securities

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Corporate and government securities and commercial loans:			
Government	4,884	7,151	5,856
Publicly traded and SEC Rule 144A securities*	24,971	24,894	25,992
Non-SEC Rule 144A securities	4,543	4,302	4,576
Asset-backed securities (see note (e))	3,631	4,796	4,321
Total US debt securities†	38,029	41,143	40,745

* A 1990 SEC rule that facilitates the resale of privately placed securities under Rule 144A that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

† Debt securities for US operations included in the statement of financial position comprise:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Available-for-sale	37,936	41,045	40,645
Fair value through profit and loss:			
Securities held to back liabilities for funds withheld under reinsurance arrangement	93	98	100
	38,029	41,143	40,745

Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

(c) Movements in unrealised gains and losses on Jackson available-for-sale securities

There was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £676 million to a net unrealised gain of £1,157 million as analysed in the table below:

	30 Jun 2017 £m	Foreign exchange translation†	Changes in unrealised appreciation	31 Dec 2016 £m
	Reflected as part of movement in other comprehensive income			
Assets fair valued at below book value				
Book value*	8,760			14,617
Unrealised (loss) gain	(306)	22	347	(675)
Fair value (as included in statement of financial position)	8,454			13,942
Assets fair valued at or above book value				
Book value*	28,019			25,352
Unrealised gain (loss)	1,463	(72)	184	1,351
Fair value (as included in statement of financial position)	29,482			26,703
Total				
Book value*	36,779			39,969
Net unrealised gain (loss)	1,157	(50)	531	676
Fair value (as included in the footnote above in the overview table and the statement of financial position)	37,936			40,645

The available-for-sale debt securities of Jackson are analysed into US Treasuries and other debt securities as follows:

	30 Jun 2017 £m	Foreign exchange translation [†]	Changes in unrealised appreciation	31 Dec 2016 £m
	Reflected as part of movement in other comprehensive income			
US Treasuries				
Book value*	4,415			5,486
Unrealised (loss) gain	(186)	13	213	(412)
Fair value	4,229			5,074
Other debt securities				
Book value*	32,364			34,483
Unrealised gain (loss)	1,343	(63)	318	1,088
Fair value	33,707			35,571
Total debt securities				
Book value*	36,779			39,969
Net unrealised gain (loss)	1,157	(50)	531	676
Fair value	37,936			40,645

* Book value represents cost/amortised cost of the debt securities.

† Translated at the average rate of US\$1.2599: £1.00.

(d) US debt securities classified as available-for-sale in an unrealised loss position

(i) Fair value of securities as a percentage of book value

The following table shows the fair value of the debt securities in a gross unrealised loss position for various percentages of book value:

	30 Jun 2017 £m		30 Jun 2016 £m		31 Dec 2016 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
Between 90% and 100%	7,962	(236)	1,848	(51)	12,326	(405)
Between 80% and 90%	482	(64)	304	(52)	1,598	(259)
Below 80%:						
Residential mortgage-backed securities – sub-prime	–	–	–	–	–	–
Commercial mortgage-backed securities	–	–	8	(3)	8	(3)
Other asset-backed securities	10	(6)	9	(7)	9	(8)
Government bonds	–	–	–	–	–	–
Corporates	–	–	19	(6)	1	–
	10	(6)	36	(16)	18	(11)
Total	8,454	(306)	2,188	(119)	13,942	(675)

(ii) Unrealised loss by maturity of security

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
1 year to 5 years	(5)	(10)	(7)
5 years to 10 years	(48)	(38)	(118)
More than 10 years	(231)	(42)	(510)
Mortgage-backed and other debt securities	(22)	(29)	(40)
Total	(306)	(119)	(675)

C Balance sheet notes

Continued

C3 Assets and liabilities – classification and measurement continued

C3.2 Debt securities continued

(iii) Age analysis of unrealised losses for the periods indicated

The following table shows the age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

Age analysis	30 Jun 2017 £m			30 Jun 2016 £m			31 Dec 2016 £m		
	Non-investment grade	Investment grade	Total	Non-investment grade	Investment grade	Total	Non-investment grade	Investment grade	Total
Less than 6 months	(1)	(15)	(16)	(2)	(5)	(7)	(3)	(599)	(602)
6 months to 1 year	–	(251)	(251)	(4)	(8)	(12)	–	(2)	(2)
1 year to 2 years	(2)	(1)	(3)	(14)	(46)	(60)	(4)	(27)	(31)
2 years to 3 years	(3)	(12)	(15)	–	–	–	(2)	(1)	(3)
More than 3 years	(1)	(20)	(21)	(3)	(37)	(40)	(2)	(35)	(37)
	(7)	(299)	(306)	(23)	(96)	(119)	(11)	(664)	(675)

Further, the following table shows the age analysis as at 30 June 2017 of the securities whose fair values were below 80 per cent of the book value:

Age analysis	30 Jun 2017 £m		30 Jun 2016 £m		31 Dec 2016 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
Less than 3 months	–	–	2	–	1	–
3 months to 6 months	–	–	19	(6)	–	–
More than 6 months	10	(6)	15	(10)	17	(11)
	10	(6)	36	(16)	18	(11)

(e) Asset-backed securities

The Group's holdings in asset-backed securities (ABS), which comprise residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDO) funds and other asset-backed securities, at 30 June 2017 are as follows:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Shareholder-backed operations:			
Asia insurance operations ^{note (i)}	104	151	130
US insurance operations ^{note (ii)}	3,631	4,796	4,321
UK insurance operations (2017: 35% AAA, 19% AA) ^{note (iii)}	1,045	1,445	1,464
Asset management operations ^{note (iv)}	665	963	771
	5,445	7,355	6,686
With-profits operations:			
Asia insurance operations ^{note (i)}	233	310	357
UK insurance operations (2017: 56% AAA, 13% AA) ^{note (iii)}	5,091	4,558	5,177
	5,324	4,868	5,534
Total	10,769	12,223	12,220

Notes

(i) Asia insurance operations

The Asia insurance operations' exposure to asset-backed securities is primarily held by the with-profits operations. Of the £233 million, 99 per cent (30 June 2016: 99 per cent; 31 December 2016: 99 per cent) are investment grade.

(ii) US insurance operations

US insurance operations' exposure to asset-backed securities at 30 June 2017 comprises:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
RMBS			
Sub-prime (2017: 2% AAA, 11% AA, 3% A)	150	185	180
Alt-A (2017: 3% AAA, 5% A)	151	178	177
Prime including agency (2017: 70% AA, 5% A)	515	904	675
CMBS (2017: 80% AAA, 14% AA, 1% A)	1,768	2,635	2,234
CDO funds (2017: 23% AAA, 8% AA, 43% A), including £nil exposure to sub-prime	33	55	50
Other ABS (2017: 17% AAA, 17% AA, 51% A), including £108 million exposure to sub-prime	1,014	839	1,005
Total	3,631	4,796	4,321

(iii) UK insurance operations

The majority of holdings of the shareholder-backed business are UK securities and relate to PAC's annuity business. Of the holdings of the with-profits operations, £1,473 million (30 June 2016: £1,332 million; 31 December 2016: £1,623 million) relates to exposure to the US markets with the remaining exposure being primarily to the UK market.

(iv) Asset management operations

Asset management operations' exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £665 million, 96 per cent (30 June 2016: 95 per cent; 31 December 2016: 95 per cent) are graded AAA.

(f) Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities at 30 June 2017 are analysed as follows:

Exposure to sovereign debts

	30 Jun 2017 £m		30 Jun 2016 £m		31 Dec 2016 £m	
	Shareholder-backed business	With-profits funds	Shareholder-backed business	With-profits funds	Shareholder-backed business	With-profits funds
Italy	57	62	58	63	56	61
Spain	33	18	35	18	33	18
France	23	23	22	–	22	–
Germany*	649	317	546	348	573	329
Other Europe (principally Belgium)	82	32	84	32	83	33
Total Eurozone	844	452	745	461	767	441
United Kingdom	4,904	3,049	5,720	2,431	5,510	2,868
United States†	4,959	9,913	6,881	8,354	6,861	9,008
Other, predominantly Asia	4,174	2,221	4,081	2,073	3,979	2,079
Total	14,881	15,635	17,427	13,319	17,117	14,396

* Including bonds guaranteed by the federal government.

† The exposure to the United States sovereign debt comprises holdings of Jackson, the UK and Asia insurance operations.

C Balance sheet notes

Continued

C3 Assets and liabilities – classification and measurement continued

C3.2 Debt securities continued

Exposure to bank debt securities

	2017 £m							2016 £m	
	Senior debt			Subordinated debt			30 Jun Total	30 Jun Total	31 Dec Total
	Covered	Senior	Total senior debt	Tier 1	Tier 2	Total subordinated debt			
Shareholder-backed business									
Italy	–	32	32	–	–	–	32	31	32
Spain	43	16	59	–	–	–	59	159	170
France	28	52	80	10	73	83	163	224	166
Germany	76	4	80	–	87	87	167	124	124
Netherlands	–	67	67	–	6	6	73	39	50
Other Eurozone	–	23	23	–	–	–	23	32	19
Total Eurozone	147	194	341	10	166	176	517	609	561
United Kingdom	698	387	1,085	6	310	316	1,401	1,118	1,174
United States	–	2,580	2,580	3	174	177	2,757	2,651	2,684
Other, predominantly Asia	33	600	633	85	420	505	1,138	1,041	1,018
Total	878	3,761	4,639	104	1,070	1,174	5,813	5,419	5,437
With-profits funds									
Italy	–	65	65	–	–	–	65	64	62
Spain	44	41	85	–	–	–	85	219	213
France	9	200	209	–	64	64	273	274	213
Germany	112	20	132	–	35	35	167	112	114
Netherlands	–	192	192	5	7	12	204	200	202
Other Eurozone	–	30	30	–	–	–	30	30	31
Total Eurozone	165	548	713	5	106	111	824	899	835
United Kingdom	790	515	1,305	2	485	487	1,792	1,532	1,396
United States	–	1,985	1,985	16	333	349	2,334	1,978	2,229
Other, predominantly Asia	400	1,012	1,412	258	463	721	2,133	1,775	1,992
Total	1,355	4,060	5,415	281	1,387	1,668	7,083	6,184	6,452

The tables above exclude assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the tables above exclude the proportionate share of sovereign debt holdings of the Group's joint venture and associate operations.

C3.3 Loans portfolio

(a) Overview of loans portfolio

Loans are principally accounted for at amortised cost, net of impairment except for:

- Certain mortgage loans which have been designated at fair value through profit or loss of the UK insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and
- Certain policy loans of the US insurance operations which are held to back liabilities for funds withheld under a reinsurance arrangement and are also accounted for on a fair value basis.

The amounts included in the statement of financial position are analysed as follows:

	30 Jun 2017 £m				30 Jun 2016 £m				31 Dec 2016 £m			
	Mortgage loans [*]	Policy loans [†]	Other loans [‡]	Total	Mortgage loans [*]	Policy loans [†]	Other loans [‡]	Total	Mortgage loans [*]	Policy loans [†]	Other loans [‡]	Total
Asia												
With-profits	–	589	113	702	–	539	113	652	–	577	113	690
Non-linked shareholder-backed	188	219	198	605	156	294	176	626	179	226	208	613
US												
Non-linked shareholder-backed	5,964	3,533	–	9,497	5,109	3,395	–	8,504	6,055	3,680	–	9,735
UK												
With-profits	2,576	5	1,455	4,036	719	6	1,339	2,064	668	6	1,218	1,892
Non-linked shareholder-backed	1,711	–	37	1,748	1,548	–	4	1,552	1,642	–	38	1,680
Asset management operations	–	–	364	364	–	–	817	817	–	–	563	563
Total loans securities	10,439	4,346	2,167	16,952	7,532	4,234	2,449	14,215	8,544	4,489	2,140	15,173

* All mortgage loans are secured by properties.

† In the US £2,594 million (30 June 2016: £2,448 million; 31 December 2016: £2,672 million) policy loans are backing liabilities for funds withheld under reinsurance arrangements and are accounted for at fair value through profit or loss. All other policy loans are accounted for at amortised cost, less any impairment.

‡ Other loans held in UK with-profits funds are commercial loans and comprise mainly syndicated loans. The majority of other loans in shareholder-backed business in Asia are commercial loans held by the Malaysia operation and which are all investment graded by two local rating agencies.

(b) Additional information on US mortgage loans

In the US, mortgage loans are all commercial mortgage loans that are secured on the following property types: industrial, multi-family residential, suburban office, retail or hotel. The US insurance operations' commercial mortgage loan portfolio does not include any single-family residential mortgage loans and is therefore not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The average loan size is £12.5 million (30 June 2016: £10.2 million; 31 December 2016: £12.4 million). The portfolio has a current estimated average loan to value of 59 per cent (30 June 2016 and 31 December 2016: 59 per cent).

At 30 June 2017, Jackson had no mortgage loans where the contractual terms of the agreements had been restructured (30 June 2016 and 31 December 2016: none).

(c) Additional information on UK mortgage loans

During the first half of 2017, the UK with-profits fund invested in an entity established to acquire a portfolio of buy-to-let mortgage loans. The vehicle financed the acquisition through the issue of debt instruments, largely to external parties, securitised upon the mortgages acquired. These third-party borrowings have no recourse to any other assets of the Group and the Group's exposure is limited to the amount invested by the UK with-profits fund. The securitisation entity is consolidated under IFRS with the mortgage loans and the related third-party non-recourse borrowings (see note C6.2 (b)) carried at fair value through profit or loss as they are managed and evaluated by the Group on a fair value basis.

By carrying value, 100 per cent of the £1,711 million (30 June 2016: 76 per cent of £1,548 million; 31 December 2016: 96 per cent of £1,642 million) mortgage loans held by the UK shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 30 per cent (30 June 2016: 29 per cent; 2016: 30 per cent).

(d) Loans held by asset management operations

These relate to loans and receivables managed by Prudential Capital. These assets are generally secured but most have no external credit ratings. Internal ratings prepared by the Group's asset management operations, as part of the risk management process, are:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Loans and receivables internal ratings:			
AA+ to AA-	21	31	29
A+ to A-	97	120	100
BBB+ to BBB-	146	442	248
BB+ to BB-	100	223	185
B and other	–	1	1
Total	364	817	563

C Balance sheet notes

Continued

C4 Policyholder liabilities and unallocated surplus of with-profits funds

The note provides information of policyholder liabilities and unallocated surplus of with-profits funds held on the Group's statement of financial position.

C4.1 Movement of liabilities

C4.1(a) Group overview

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

Half year 2017 movements	Insurance operations £m			Total
	Asia* note C4.1(b)	US note C4.1(c)	UK note C4.1(d)	
At 1 January 2017	62,784	177,626	169,304	409,714
<i>Comprising:</i>				
– Policyholder liabilities on the consolidated statement of financial position [†]	53,716	177,626	157,654	388,996
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,667	–	11,650	14,317
– Group's share of policyholder liabilities of joint ventures and associate [‡]	6,401	–	–	6,401
Net flows:				
Premiums	5,699	8,148	7,756	21,603
Surrenders	(1,508)	(5,071)	(3,816)	(10,395)
Maturities/deaths	(880)	(1,119)	(3,533)	(5,532)
Net flows	3,311	1,958	407	5,676
Shareholders' transfers post tax	(27)	–	(115)	(142)
Investment-related items and other movements	4,288	7,124	5,214	16,626
Foreign exchange translation differences	(2,035)	(8,929)	130	(10,834)
As at 30 June 2017	68,321	177,779	174,940	421,040
<i>Comprising:</i>				
– Policyholder liabilities on the consolidated statement of financial position [†]	58,348	177,779	162,853	398,980
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,003	–	12,087	15,090
– Group's share of policyholder liabilities of joint ventures and associate [‡]	6,970	–	–	6,970
Half year 2016 movements				
At 1 January 2016	45,966	138,913	152,893	337,772
<i>Comprising:</i>				
– Policyholder liabilities excluding Korea life*	38,443	138,913	142,350	319,706
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,553	–	10,543	13,096
– Group's share of policyholder liabilities of joint ventures and associate [‡]	4,970	–	–	4,970
Net flows:				
Premiums	4,191	7,101	5,561	16,853
Surrenders	(992)	(3,437)	(3,208)	(7,637)
Maturities/deaths	(671)	(809)	(3,470)	(4,950)
Net flows	2,528	2,855	(1,117)	4,266
Shareholders' transfers post tax	(22)	–	(110)	(132)
Investment-related items and other movements	2,232	2,737	10,092	15,061
Foreign exchange translation differences	6,280	14,650	721	21,651
At 30 June 2016	56,984	159,155	162,479	378,618
<i>Comprising:</i>				
– Policyholder liabilities excluding Korea life*	48,918	159,155	151,233	359,306
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,351	–	11,246	13,597
– Group's share of policyholder liabilities of joint ventures and associate [‡]	5,715	–	–	5,715
Average policyholder liability balances[§]				
Half year 2017	62,718	177,702	160,254	400,674
Half year 2016*	49,023	149,034	146,792	344,849

* The sale of the Group's Korea life business was completed in May 2017. Accordingly, no amounts are shown in the half year 2017 analysis above for Korea. The half year 2016 comparatives have been correspondingly adjusted. The amounts excluded from policyholder liabilities as presented in the balance sheet are £2,812 million at 1 January 2016 and £3,204 million at 30 June 2016.

† The policyholder liabilities of the Asia insurance operations of £58,348 million as shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,271 million to the Hong Kong with-profits business.

‡ The Group's investments in joint ventures and associates are accounted for on the equity method in the Group's statement of financial position. The Group's share of the policyholder liabilities as shown above relates to life businesses in China, India and of the Takaful business in Malaysia.

§ Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions in the period and exclude unallocated surplus of with-profits funds.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the period. The items above are shown gross of external reinsurance.

The analysis includes the impact of premiums, claims and investment movements on policyholders' liabilities. The impact does not represent premiums, claims and investment movements as reported in the income statement. For example, the premiums shown above are after any deductions for fees/charges, and claims represent the policyholder liabilities provision released rather than the claim amount paid to the policyholder.

(ii) Analysis of movements in policyholder liabilities for shareholder-backed business

	Half year 2017 £m			
	Asia	US	UK	Total note (b)
At 1 January 2017	32,851	177,626	56,158	266,635
Net flows:				
Premiums	2,801	8,148	1,658	12,607
Surrenders	(1,335)	(5,071)	(1,500)	(7,906)
Maturities/deaths	(450)	(1,119)	(1,325)	(2,894)
Net flows ^{note (a)}	1,016	1,958	(1,167)	1,807
Investment-related items and other movements	1,912	7,124	1,500	10,536
Foreign exchange translation differences	(739)	(8,929)	–	(9,668)
At 30 June 2017	35,040	177,779	56,491	269,310
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	28,070	177,779	56,491	262,340
– Group's share of policyholder liabilities relating to joint ventures and associate	6,970	–	–	6,970
	Half year 2016 £m			
	Asia note (b)	US	UK	Total
At 1 January 2016	25,032	138,913	52,824	216,769
Net flows:				
Premiums	2,090	7,101	869	10,060
Surrenders	(829)	(3,437)	(1,311)	(5,577)
Maturities/deaths	(284)	(809)	(1,257)	(2,350)
Net flows ^{notes (a)(b)}	977	2,855	(1,699)	2,133
Investment-related items and other movements	841	2,737	4,285	7,863
Foreign exchange translation differences	3,294	14,650	1	17,945
At 30 June 2016	30,144	159,155	55,411	244,710
Comprising:				
– Policyholder liabilities excluding Korea life ^{note (b)}	24,429	159,155	55,411	238,995
– Group's share of policyholder liabilities relating to joint ventures and associate	5,715	–	–	5,715

Notes

(a) Including net flows of the Group's insurance joint ventures and associate.

(b) The sale of the Group's Korea life business was completed in May 2017. Accordingly, no amounts are shown in the half year 2017 analysis above for Korea. The half year 2016 comparatives have been correspondingly adjusted. The amounts excluded from policyholder liabilities as presented in the balance sheet are £2,812 million at 1 January 2016 and £3,204 million at 30 June 2016.

C Balance sheet notes

Continued

C4 Policyholder liabilities and unallocated surplus of with-profits funds continued

C4.1 Movement of liabilities continued

C4.1(b) Asia insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of Asia insurance operations from the beginning of the period to 30 June is as follows:

Half year 2017 movements	With-profits business* £m	Unit-linked liabilities £m	Other business £m	Total £m
At 1 January 2017	29,933	17,507	15,344	62,784
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	27,266	14,289	12,161	53,716
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,667	–	–	2,667
– Group's share of policyholder liabilities relating to joint ventures and associate [†]	–	3,218	3,183	6,401
Premiums:				
New business	676	527	528	1,731
In-force	2,222	805	941	3,968
	2,898	1,332	1,469	5,699
Surrenders ^{note (a)}	(173)	(1,102)	(233)	(1,508)
Maturities/deaths	(430)	(82)	(368)	(880)
Net flows ^{note (b)}	2,295	148	868	3,311
Shareholders' transfers post tax	(27)	–	–	(27)
Investment-related items and other movements ^{note (c)}	2,376	1,551	361	4,288
Foreign exchange translation differences ^{note (d)}	(1,296)	(373)	(366)	(2,035)
At 30 June 2017	33,281	18,833	16,207	68,321
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position*	30,278	15,326	12,744	58,348
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,003	–	–	3,003
– Group's share of policyholder liabilities relating to joint ventures and associate [†]	–	3,507	3,463	6,970

Half year 2016 movements[‡]	With-profits business[*] £m	Unit-linked liabilities £m	Other business £m	Total £m
At 1 January 2016	20,934	13,779	11,253	45,966
Comprising:				
– Policyholder liabilities excluding Korea life [‡]	18,381	11,168	8,894	38,443
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,553	–	–	2,553
– Group's share of policyholder liabilities relating to joint ventures and associate [‡]	–	2,611	2,359	4,970
Premiums:				
New business	706	366	335	1,407
In-force	1,395	686	703	2,784
	2,101	1,052	1,038	4,191
Surrenders ^{note (a)}	(163)	(679)	(150)	(992)
Maturities/deaths	(387)	(27)	(257)	(671)
Net flows ^{note (b)}	1,551	346	631	2,528
Shareholders' transfers post tax	(22)	–	–	(22)
Investment-related items and other movements ^{note (c)}	1,391	97	744	2,232
Foreign exchange translation differences ^{note (d)}	2,986	1,902	1,392	6,280
At 30 June 2016	26,840	16,124	14,020	56,984
Comprising:				
– Policyholder liabilities excluding Korea life [‡]	24,489	13,224	11,205	48,918
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,351	–	–	2,351
– Group's share of policyholder liabilities relating to joint ventures and associate [‡]	–	2,900	2,815	5,715
Average policyholder liability balances [§]				
Half year 2017	28,772	18,170	15,776	62,718
Half year 2016 [‡]	21,435	14,951	12,637	49,023

* The policyholder liabilities of the with-profits business of £30,278 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK insurance operations of £1,271 million to the Hong Kong with-profits business.

† The Group's investments in joint ventures and associates are accounted for on an equity method and the Group's share of the policyholder liabilities as shown above relate to the life business in China, India and of the Takaful business in Malaysia.

‡ The sale of the Group's Korea life business was completed in May 2017. Accordingly, no amounts are shown in the half year 2017 analysis above for Korea. The half year 2016 comparatives have been correspondingly adjusted. The amounts excluded from policyholder liabilities as presented in the balance sheet are £2,812 million at 1 January 2016 and £3,204 million at 30 June 2016.

§ Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions in the period and exclude unallocated surplus of with-profits funds.

Notes

- (a) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 4.1 per cent in the first half of 2017 (half year 2016: 3.3 per cent).
- (b) Net flows increased by 31 per cent from £2,528 million in half year 2016 to £3,311 million in half year 2017 predominantly reflecting continued growth of the in-force book and increased flows from new business.
- (c) Investment-related items and other movements in the first half of 2017 primarily represent gains on equities and bonds during the period.
- (d) Movements in the period have been translated at the average exchange rates for the period ended 30 June 2017. The closing balance has been translated at the closing spot rates as at 30 June 2017. Differences upon retranslation are included in foreign exchange translation differences.

C Balance sheet notes

Continued

C4 Policyholder liabilities and unallocated surplus of with-profits funds continued

C4.1 Movement of liabilities continued

C4.1(c) US insurance operations

(i) Analysis of movements in policyholder liabilities

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the period to 30 June is as follows:

US insurance operations

	Variable annuity separate account liabilities £m	Fixed annuity, GIC and other business £m	Total £m
Half year 2017 movements			
At 1 January 2017	120,411	57,215	177,626
Premiums	5,981	2,167	8,148
Surrenders	(3,409)	(1,662)	(5,071)
Maturities/deaths	(541)	(578)	(1,119)
Net flows ^{note (a)}	2,031	(73)	1,958
Transfers from general to separate account	1,240	(1,240)	–
Investment-related items and other movements ^{note (b)}	7,236	(112)	7,124
Foreign exchange translation differences ^{note (c)}	(6,183)	(2,746)	(8,929)
At 30 June 2017	124,735	53,044	177,779
Half year 2016 movements			
At 1 January 2016	91,022	47,891	138,913
Premiums	4,848	2,253	7,101
Surrenders	(2,168)	(1,269)	(3,437)
Maturities/deaths	(384)	(425)	(809)
Net flows ^{note (a)}	2,296	559	2,855
Transfers from general to separate account	169	(169)	–
Investment-related items and other movements	843	1,894	2,737
Foreign exchange translation differences ^{note (c)}	9,574	5,076	14,650
At 30 June 2016	103,904	55,251	159,155
Average policyholder liability balances*			
Half year 2017	122,573	55,129	177,702
Half year 2016	97,463	51,571	149,034

* Averages have been based on opening and closing balances, and adjusted for any acquisitions, disposals and corporate transactions in the period.

Notes

- (a) Net flows in the first half of 2017 were £1,958 million (2016: £2,855 million) as we continue to grow the business with gross inflows of £8,148 million, principally into variable annuities, more than exceeding surrenders and maturities in the period.
- (b) Positive investment-related items and other movements in variable annuity separate account liabilities of £7,236 million for the first six months in 2017 represents positive separate account return mainly following the increase in the US equity market in the period.
- (c) Movements in the period have been translated at an average rate of US\$1.26:£1.00 (30 June 2016: US\$1.43:£1.00). The closing balance has been translated at a closing rate of US\$1.30:£1.00 (30 June 2016: US\$1.34:£1.00). Differences upon retranslation are included in foreign exchange translation differences.

C4.1(d) UK insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK insurance operations from the beginning of the period to 30 June is as follows:

	Shareholder-backed funds and subsidiaries			
	SAIF and PAC with-profits sub-fund £m	Unit-linked liabilities £m	Annuity and other long-term business £m	Total £m
Half year 2017 movements				
At 1 January 2017	113,146	22,119	34,039	169,304
Comprising:				
– Policyholder liabilities	101,496	22,119	34,039	157,654
– Unallocated surplus of with-profits funds	11,650	–	–	11,650
Premiums	6,098	1,484	174	7,756
Surrenders	(2,316)	(1,472)	(28)	(3,816)
Maturities/deaths	(2,208)	(323)	(1,002)	(3,533)
Net flows ^{note (a)}	1,574	(311)	(856)	407
Shareholders' transfers post tax	(115)	–	–	(115)
Switches	(91)	91	–	–
Investment-related items and other movements ^{note (b)}	3,805	1,018	391	5,214
Foreign exchange translation differences	130	–	–	130
At 30 June 2017	118,449	22,917	33,574	174,940
Comprising:				
– Policyholder liabilities	106,362	22,917	33,574	162,853
– Unallocated surplus of with-profits funds	12,087	–	–	12,087
Half year 2016 movements				
At 1 January 2016	100,069	21,442	31,382	152,893
Comprising:				
– Policyholder liabilities	89,526	21,442	31,382	142,350
– Unallocated surplus of with-profits funds	10,543	–	–	10,543
Premiums	4,692	527	342	5,561
Surrenders	(1,897)	(1,285)	(26)	(3,208)
Maturities/deaths	(2,213)	(271)	(986)	(3,470)
Net flows ^{note (a)}	582	(1,029)	(670)	(1,117)
Shareholders' transfers post tax	(110)	–	–	(110)
Switches	(84)	84	–	–
Investment-related items and other movements ^{note (b)}	5,891	1,050	3,151	10,092
Foreign exchange translation differences	720	1	–	721
At 30 June 2016	107,068	21,548	33,863	162,479
Comprising:				
– Policyholder liabilities	95,822	21,548	33,863	151,233
– Unallocated surplus of with-profits funds	11,246	–	–	11,246
Average policyholder liability balances*				
Half year 2017	103,929	22,518	33,807	160,254
Half year 2016	92,674	21,495	32,623	146,792

* Averages have been based on opening and closing balances, and adjusted for any acquisitions, disposals and corporate transactions in the period, and exclude unallocated surplus of with-profits funds.

Notes

- (a) Net flows have improved from a net outflow of £1,117 million in the first half of 2016 to net inflows of £407 million in the same period of 2017 due primarily to higher premium flows, up by £2,195 million to £7,756 million, following increased sales of with-profits savings and retirement products. This has been partially offset by lower premiums into our annuity business due to our withdrawal from selling new annuity business. The level of inflows/outflows for unit-linked business remains subject to annual variation as it is driven by corporate pension schemes with transfers in or out from a small number of schemes influencing the level of flows in the period.
- (b) Investment-related items and other movements of £5,214 million principally comprise investment return attributable to policyholders earned in the period reflecting favourable equity market movements.

C Balance sheet notes

Continued

C5 Intangible assets

(a) Goodwill

	Attributable to:		2017 £m	2016 £m	
	Shareholders	With-profits		30 Jun	31 Dec
			30 Jun		
Cost					
At beginning of year	1,475	153	1,628	1,648	1,648
Disposals	–	(127)	(127)	–	–
Charge for reclassification as held for sale	–	–	–	–	(56)
Additional consideration paid on previously acquired business	–	–	–	1	7
Exchange differences	–	–	–	28	29
Net book amount at end of year	1,475	26	1,501	1,677	1,628

Goodwill comprises:

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
M&G – attributable to shareholders	1,153	1,153	1,153
Other – attributable to shareholders	322	335	322
Goodwill – attributable to shareholders	1,475	1,488	1,475
Venture fund investments – attributable to with-profits funds	26	189	153
	1,501	1,677	1,628

Other goodwill represents amounts arising from the purchase of entities by the Asia and US operations. These goodwill amounts relating to acquired operations are not individually material.

(b) Deferred acquisition costs and other intangible assets

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Deferred acquisition costs and other intangible assets attributable to shareholders	10,643	9,549	10,755
Deferred acquisition costs and other intangible assets attributable to with-profits funds	114	45	52
Total of deferred acquisition costs and other intangible assets	10,757	9,594	10,807

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

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Deferred acquisition costs related to insurance contracts as classified under IFRS 4	9,022	8,010	9,114
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4	60	68	64
	9,082	8,078	9,178
Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF)	39	48	43
Distribution rights and other intangibles	1,522	1,423	1,534
	1,561	1,471	1,577
Total of deferred acquisition costs and other intangible assets	10,643	9,549	10,755

	2017 £m					2016 £m		
	Deferred acquisition costs					30 Jun Total	30 Jun Total	31 Dec Total
	Asia	US	UK	Asset management	PVIF and other intangibles* note			
Balance at beginning of period:	788	8,303	79	8	1,577	10,755	8,422	8,422
Additions and acquisition of subsidiaries	122	353	8	–	58	541	516	1,179
Amortisation to the income statement:†								
Operating profit	(66)	(236)	(5)	(2)	(66)	(375)	(369)	(686)
Non-operating profit	–	231	–	–	(4)	227	616	557
	(66)	(5)	(5)	(2)	(70)	(148)	247	(129)
Disposals and transfers‡	–	–	–	–	–	–	(2)	(268)
Exchange differences and other movements	(21)	(411)	–	–	(4)	(436)	801	1,475
Amortisation of DAC related to net unrealised valuation movements on Jackson's available-for-sale securities recognised within other comprehensive income‡	–	(69)	–	–	–	(69)	(435)	76
Balance at end of period	823	8,171	82	6	1,561	10,643	9,549	10,755

* PVIF and other intangibles includes amounts in relation to software rights with additions of £17 million, amortisation of £16 million, foreign exchange losses of £1 million and a balance at 30 June 2017 of £66 million.

† Under the Group's application of IFRS 4, US GAAP is used for measuring the insurance assets and liabilities of its US and certain Asia operations. Under US GAAP, most of the US insurance operation's products are accounted for under Accounting Standard no. 97 of the Financial Accounting Standards Board (FAS 97) whereby deferred acquisition costs are amortised in line with the emergence of actual and expected gross profits, which are determined using an assumption for long-term investment returns for the separate account of 7.4 per cent (half year 2016: 7.4 per cent) (gross of asset management fees and other charges to policyholders, but net of external fund management fees). The amounts included in the income statement and other comprehensive income affect the pattern of profit emergence and thus the DAC amortisation attaching. DAC amortisation is allocated to the operating and non-operating components of the Group's supplementary analysis of profit and other comprehensive income by reference to the underlying items.

‡ Of the £268 million of disposals and transfers at 31 December 2016, £265 million related to the reclassification of the Korea life business as held for sale.

Note

PVIF and other intangibles comprise PVIF, distribution rights and other intangibles such as software rights. Distribution rights relate to amounts that have been paid or have become unconditionally due for payment as a result of past events in respect of bancassurance partnership arrangements in Asia. These agreements allow for bank distribution of Prudential's insurance products for a fixed period of time.

US insurance operations

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

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Variable annuity business	8,133	7,266	7,844
Other business	330	558	696
Cumulative shadow DAC (for unrealised gains/losses booked in other comprehensive income)*	(292)	(763)	(237)
Total DAC for US operations	8,171	7,061	8,303

* Consequent upon the positive unrealised valuation movement for half year 2017 of £531 million (30 June 2016: positive unrealised valuation movement of £2,118 million; 31 December 2016: negative unrealised valuation movement of £28 million), there is a charge of £69 million (30 June 2016: a charge of £435 million; 31 December 2016: a gain of £76 million) for altered 'shadow' DAC amortisation booked within other comprehensive income. These adjustments reflect the movement from period to period, in the changes to the pattern of reported gross profits that would have happened if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 30 June 2017, the cumulative shadow DAC balance as shown in the table above was negative £292 million (30 June 2016: negative £763 million; 31 December 2016: negative £237 million).

C Balance sheet notes

Continued

C5 Intangible assets continued

Sensitivity of amortisation charge

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

- (i) A core amount that reflects a relatively stable proportion of underlying premiums or profit; and
- (ii) An element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique (which is used for moderating the effect of short-term volatility in investment returns) are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

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

In the first half of 2017, the DAC amortisation charge for operating profit was determined after including a credit for decelerated amortisation of £36 million (half year 2016: £29 million; full year 2016: £93 million). The first half of 2017 amount reflects the impact of the positive separate account performance, which is higher than the assumed level for the period.

The application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation, while the mean reversion assumption lies within the corridor. At 1 July 2017, it would take an instantaneous movement in separate account values of approximately more than either negative 25 per cent or positive 41 per cent for the mean reversion assumption to move outside the corridor.

C6 Borrowings

C6.1 Core structural borrowings of shareholder-financed operations

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Holding company operations:			
Perpetual subordinated notes (Tier 1) ^{note (i)}	847	823	890
Perpetual subordinated notes (Tier 2) ^{note (i)}	2,620	2,007	2,754
Subordinated notes (Tier 2) ^{note (i)}	2,131	2,126	2,128
Subordinated debt total	5,598	4,956	5,772
Senior debt: ^{note (ii)}			
£300m 6.875% Bonds 2023	300	300	300
£250m 5.875% Bonds 2029	249	249	249
Holding company total	6,147	5,505	6,321
Prudential Capital bank loan ^{note (iii)}	275	275	275
Jackson US\$250m 8.15% Surplus Notes 2027	192	186	202
Total (per condensed consolidated statement of financial position) ^{note (iv)}	6,614	5,966	6,798

Notes

- (i) These debt tier classifications (including those noted for the comparative balances) are consistent with the treatment of capital for regulatory purposes under the Solvency II regime.
The Group has designated US\$4.5 billion (30 June 2016: US\$2.80 billion; 31 December 2016: US\$4.5 billion) of its perpetual subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the investment in Jackson.
- (ii) The senior debt ranks above subordinated debt in the event of liquidation.
- (iii) The Prudential Capital bank loan of £275 million is drawn at a cost of 12 month GBP LIBOR plus 0.4 per cent and matures on 20 December 2017.
- (iv) The maturity profile, currency and interest rates applicable to all other core structural borrowings of shareholder-financed operations of the Group are as detailed in note C6.1 of the Group's consolidated financial statements for the year ended 31 December 2016.

Prudential plc has debt ratings from Standard & Poor's, Moody's and Fitch. The long-term senior debt of Prudential plc is rated A+, A2 and A from Standard & Poor's, Moody's and Fitch, while short-term ratings are A-1, P-1 and F1 respectively.

The financial strength of The Prudential Assurance Company Limited is rated AA by Standard & Poor's, Aa3 by Moody's and AA by Fitch.

Jackson National Life Insurance Company's financial strength is rated AA by Standard & Poor's, A1 by Moody's, AA by Fitch and A+ by AM Best.

The financial strength of Prudential Assurance Co. Singapore (Pte) Ltd. (Prudential Singapore) is rated AA by Standard & Poor's.

All ratings on Prudential and its subsidiaries have been reaffirmed on stable outlook.

C6.2 Other borrowings

(a) Operational borrowings attributable to shareholder-financed operations

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Borrowings in respect of short-term fixed income securities programmes	1,424	2,554	1,651
Other borrowings ^{note}	672	244	666
Total	2,096	2,798	2,317

Note

Other borrowings mainly include senior debt issued through the Federal Home Loan Bank of Indianapolis (FHLB), secured by collateral posted with the FHLB by Jackson. In addition, other borrowings include amounts whose repayment to the lender is contingent upon future surplus emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(b) Borrowings attributable to with-profits operations

	2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec
Non-recourse borrowings of consolidated investment funds*	3,178	1,248	1,189
£100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc†	100	100	100
Other borrowings (predominantly obligations under finance leases)	58	79	60
Total	3,336	1,427	1,349

* In all instances the holders of the debt instruments issued by these subsidiaries and funds do not have recourse beyond the assets of those subsidiaries and funds. The increase since 31 December 2016 primarily relates to the debt instruments issued by a new consolidated securitisation entity backed by a portfolio of mortgage loans (see note C3.3(c) for further details).

† The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinated to the entitlements of the policyholders of that fund.

C Balance sheet notes

Continued

C7 Deferred tax

The statement of financial position contains the following deferred tax assets and liabilities in relation to:

	Deferred tax assets			Deferred tax liabilities		
	2017 £m	2016 £m		2017 £m	2016 £m	
	30 Jun	30 Jun	31 Dec	30 Jun	30 Jun	31 Dec
Unrealised losses or gains on investments	21	22	23	(1,774)	(1,815)	(1,534)
Balances relating to investment and insurance contracts	–	1	1	(796)	(655)	(730)
Short-term temporary differences	4,002	3,690	4,196	(3,059)	(2,893)	(3,071)
Capital allowances	16	12	16	(54)	(34)	(35)
Unused tax losses	66	46	79	–	–	–
Total	4,105	3,771	4,315	(5,683)	(5,397)	(5,370)

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

The taxation regimes applicable across the Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the recognition of deferred tax assets. For the 2017 half year results and financial position at 30 June 2017 the tax benefits on the following losses have not been recognised:

	2017		2016			
	30 Jun		30 Jun		31 Dec	
	Tax benefit £m	Losses £bn	Tax benefit £m	Losses £bn	Tax benefit £m	Losses £bn
Capital losses	90	0.4	94	0.5	89	0.4
Trading losses	48	0.2	60	0.3	41	0.2

Of the unrecognised trading losses, £33 million will expire within the next seven years, the rest have no expiry date.

Under IAS 12, 'Income Taxes', deferred tax is measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on the tax rates (and laws) that have been enacted or are substantively enacted at the end of the reporting period.

C8 Defined benefit pension schemes

(a) IAS 19 financial positions

The Group operates a number of pension schemes. The largest defined benefit scheme is the Prudential Staff Pension Scheme (PSPS), which is the principal scheme in the UK. The Group also operates two smaller UK defined benefit schemes in respect of Scottish Amicable (SASPS) and M&G (M&GGPS). In addition, there are two small defined benefit schemes in Taiwan which have negligible deficits.

The Group asset/liability in respect of defined benefit pension schemes is as follows:

	2017 £m					2016 £m									
	30 Jun					30 Jun					31 Dec				
	PSPS	SASPS	M&GGPS	Other schemes	Total	PSPS	SASPS	M&GGPS	Other schemes	Total	PSPS	SASPS	M&GGPS	Other schemes	Total
Underlying economic surplus (deficit)	753	(154)	85	(1)	683	1,270	(123)	115	(1)	1,261	717	(237)	84	(1)	563
Less: unrecognised surplus	(598)	–	–	–	(598)	(1,100)	–	–	–	(1,100)	(558)	–	–	–	(558)
Economic surplus (deficit) (including investment in Prudential insurance policies)	155	(154)	85	(1)	85	170	(123)	115	(1)	161	159	(237)	84	(1)	5
Attributable to:															
PAC with-profits fund	109	(62)	–	–	47	119	(49)	–	–	70	111	(95)	–	–	16
Shareholder-backed operations	46	(92)	85	(1)	38	51	(74)	115	(1)	91	48	(142)	84	(1)	(11)
Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies	–	–	(145)	–	(145)	–	–	(81)	–	(81)	–	–	(134)	–	(134)
IAS 19 pension asset (liability) on the Group statement of financial position*	155	(154)	(60)	(1)	(60)	170	(123)	34	(1)	80	159	(237)	(50)	(1)	(129)

* At 30 June 2017, the PSPS pension asset of £155 million (30 June 2016: £170 million; 31 December 2016: £159 million) and the other schemes' pension liabilities of £215 million (30 June 2016: £90 million; 31 December 2016: £288 million) are included within 'Other debtors' and 'Provisions' respectively in the consolidated statement of financial position.

C Balance sheet notes

Continued

C8 Defined benefit pension schemes continued

(a) IAS 19 financial positions continued

Triennial actuarial valuations

Defined benefit schemes in the UK are generally required to be subject to full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds.

The triennial valuations for the PSPS and SASPS as at 5 April 2017 and 31 March 2017 respectively are currently in progress. The next triennial valuation for the M&GGPS is at 31 December 2017.

(b) Estimated pension scheme surpluses and deficits (on an economic basis)

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on consolidation in the Group financial statements) and the liabilities of the schemes. The IAS 19 basis excludes the investments in Prudential policies. In principle, on consolidation, the investments are eliminated against policyholder liabilities of UK insurance operations, so that the formal IAS 19 position for the scheme in isolation excludes these items, and the movements on them, over the reporting periods. This treatment applies to the M&GGPS investments. However, as a substantial portion of the Company's interest in the underlying surplus of PSPS is not recognised, the adjustment is not necessary for the PSPS investments.

Movements on the pension scheme deficit determined on the economic basis are as follows, with the effect of the application of IFRIC 14 being shown separately:

	Half year 2017 £m				
	Surplus (deficit) in schemes at 1 Jan 2017	(Charge) credit to income statement	Actuarial gains and losses in other comprehensive income	Contributions paid	Surplus (deficit) in schemes at 30 Jun 2017
All schemes					
Underlying position (without the effect of IFRIC 14)					
Surplus	563	(20)	117	23	683
Less: amount attributable to PAC with-profits fund	(425)	4	(57)	(8)	(486)
Shareholders' share:					
Gross of tax surplus (deficit)	138	(16)	60	15	197
Related tax	(27)	3	(12)	(3)	(39)
Net of shareholders' tax	111	(13)	48	12	158
Application of IFRIC 14 for the derecognition of PSPS surplus					
Derecognition of surplus	(558)	(7)	(32)	(1)	(598)
Less: amount attributable to PAC with-profits fund	409	4	26	–	439
Shareholders' share:					
Gross of tax	(149)	(3)	(6)	(1)	(159)
Related tax	29	1	1	–	31
Net of shareholders' tax	(120)	(2)	(5)	(1)	(128)
With the effect of IFRIC 14					
Surplus (deficit)	5	(27)	85	22	85
Less: amount attributable to PAC with-profits fund	(16)	8	(31)	(8)	(47)
Shareholders' share:					
Gross of tax (deficit) surplus	(11)	(19)	54	14	38
Related tax	2	4	(11)	(3)	(8)
Net of shareholders' tax	(9)	(15)	43	11	30

C9 Share capital, share premium and own shares

Issued shares of 5p each fully paid	30 Jun 2017			30 Jun 2016			31 Dec 2016		
	Number of ordinary shares	Share capital £m	Share premium £m	Number of ordinary shares	Share capital £m	Share premium £m	Number of ordinary shares	Share capital £m	Share premium £m
At 1 January	2,581,061,573	129	1,927	2,572,454,958	128	1,915	2,572,454,958	128	1,915
Shares issued under share-based schemes	4,791,845	–	10	6,579,190	–	6	8,606,615	1	12
At end of period	2,585,853,418	129	1,937	2,579,034,148	128	1,921	2,581,061,573	129	1,927

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

At 30 June 2017, there were options outstanding under Save As You Earn schemes to subscribe for shares as follows:

	Number of shares to subscribe for	Share price range		Exercisable by year
		from	to	
30 June 2017	6,280,110	466p	1,155p	2022
30 June 2016	7,128,449	288p	1,155p	2021
31 December 2016	7,068,884	466p	1,155p	2022

Transactions by Prudential plc and its subsidiaries in Prudential plc shares

The Group buys and sells Prudential plc shares (own shares) either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £257 million at 30 June 2017 (30 June 2016: £185 million; 31 December 2016: £226 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 30 June 2017, 11.5 million (30 June 2016: 11.2 million; 31 December 2016: 10.7 million) Prudential plc shares with a market value of £204 million (30 June 2016: £141 million; 31 December 2016: £175 million) were held in such trusts, all of which are for employee incentive plans. The maximum number of shares held during the period was 15.1 million which was in March 2017.

The Company purchased the following number of shares in respect of employee incentive plans:

	Number of shares purchased (in millions)	Cost £m
Half year 2017	3.3	56.0
Half year 2016	3.8	49.5
Full year 2016	4.4	57.2

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 30 June 2017 was 6.7 million (30 June 2016: 4.8 million; 31 December 2016: 6.0 million) and the cost of acquiring these shares of £75 million (30 June 2016: £39 million; 31 December 2016: £61 million) is included in the cost of own shares. The market value of these shares as at 30 June 2017 was £120 million (30 June 2016: £61 million; 31 December 2016: £97 million). During 2017, these funds made a net addition of 678,131 Prudential shares (30 June 2016: net disposal of 1,280,258; 31 December 2016: net disposal of 77,423) for a net increase of £13.8 million to book cost (30 June 2016: net decrease of £14.1 million; 31 December 2016: net increase of £7.9 million).

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

Other than those set out above, the Group did not purchase, sell or redeem any Prudential plc listed securities during half year 2017 or 2016.