Registered Number 2554213

Prudential Annuities Limited

Annual Report and Financial Statements
For the year ended 31 December 2006

Prudential Annuities Limited

Incorporated and registered in England and Wales Registered Number 2554213
Registered Office: Laurence Pountney Hill, London, EC4R 0HH

Contents

Prudential Annuities Limited

Directors

D J Belsham
T V Broadman
H McKee
N T E Prettejohn
G Shaughnessy

Secretary

Prudential Group Secretarial Services Limited

Auditors

KPMG Audit Plc, London

Prudential Annuities Limited

Directors' report for the year ended 31 December 2006

Principal activity and business review

The principal activity of the Company is the writing of pension annuity long term insurance business. This will continue in 2007.

The Company ceased to accept annuity business reassured from group companies during 2004. This represented the majority of the Company's new business. The amount of new business in future years is expected to be negligible.

The results of the Company for the year as set out on pages 8 and 9, show a profit on ordinary activities before tax of £49m (2005 : £340m).

The decrease in profits compared to 2005 is mainly due to:

£40m - an increase in the provisions required for maintenance expenses.

£10m - a significantly lower investment return on the surplus assets held by the Company as a result of an increase in interest rates over 2006.

- during 2005 there were a number of one off reserve releases in respect of in-force business which have not been repeated in 2006.

The shareholders' funds of the Company total £1,625m (2005: £1,590m).

The assets and liabilities of the Company have reduced during 2006 as a result of an increase in interest rates and the payment of annuity claims.

The Company remained in a strong financial position at 31 December 2006.

Results and dividends

The state of affairs of the Company at 31 December 2006 is shown in the balance sheet on pages 9 and 10. The profit and loss account appears on pages 7 and 8. No dividend for 2006 is proposed (2005: £Nil).

Post balance sheet events

There have been no significant events affecting the Company since the balance sheet date.

Payment policy

The Company does not have any trade creditors and therefore codes or standards on payment practice and disclosure of trade creditor days are not applicable.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2006 (continued)

Share Capital

The authorised share capital of the Company is £800,000,000. There were no changes to the issued share capital in the year.

Directors and their interests

The directors who served during the year were:

D J Belsham	
T V Boardman	
M E Tucker	Resigned 9 January 2006
N E T Prettejohn	Appointed 9 January 2006
T J W Tookey	Resigned 16 March 2006
K Coleman	Appointed 18 April 2006, resigned 15 December 2006
R C Ramsden	Resigned 31 May 2006
A D Briggs	Resigned 2 October 2006
G Shaughnessy	Appointed 14 December 2006
H McKee	Appointed 15 December 2006

The interests of Mr D J Belsham, Mr N E T Prettejohn and Mr G Shaughnessy who were directors in office at the end of the year and who were also directors of the immediate parent company, The Prudential Assurance Company Limited, are shown in the annual report and financial statements of that company.

(i) The other directors in office at the end of the year had interests in shares of 5p each in Prudential plc as follows:

(a) in shares, including rights granted under the Prudential Restricted Share Plan where the directors have yet to exercise their right to receive shares, and shares held in relevant Prudential Share Incentive plans:

	01/01/06 or later date of appointment	**31/12/06**
T V Boardman	37,740	35,314
H McKee	1,726	1,726

(b) in conditional awards that have been made under the Prudential Restricted Share Plan, in which the shares are held in trust and represent the maximum awards for which rights may be granted, at the end of the relevant performance period, if the performance requirements of the Plan are met:

	01/01/06 or later date of appointment	**31/12/06**
T V Boardman	32,919	34,695
H McKee	15,425	15,425

Directors' report for the year ended 31 December 2006 (continued)

Directors and their interests (continued)

(c) in conditional awards that have been made under the Prudential 1000 Day Long Term Incentive Plan, in which shares are held in trust and represent the maximum awards for which shares may be released, at the end of the relevant performance period, if the performance requirements of the Plan are met:

	01/01/06 or later date of appointment	31/12/06
T V Boardman	20,907	20,907
H McKee	10,510	10,510

(d) in options to subscribe for shares under the Prudential Savings-Related Share Option Scheme:

	01/01/06 or later date of appointment	Granted	Exercised	Lapsed or cancelled	31/12/06
T V Boardman	5,162	-	2,865	-	2,297
H McKee	-	-	-	-	-

(ii) Except as stated above, none of the directors in office at the end of the year:

(a) had any interest in shares in, or debentures of, any Group company either at the beginning of the year or at the end of the year; or

(b) were granted or exercised any right to subscribe for shares in, or debentures of, any Group company during the year, or up to the end of the year.

Financial risk management objectives, policies and exposure

The Company's objectives and policy in relation to the management of financial risk resulting from it's financial assets and liabilities is to minimise any risk. The Company's exposure to financial risk through it's financial assets and liabilities is provided in detail in note 7 of the notes to the financial statements.

Disclosure of information to auditors

The directors who held the office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2006 (continued)

Auditors

In accordance with section 386 of the Companies Act 1985, an elective resolution has been passed by the Company dispensing with the need to appoint auditors annually. Accordingly, KPMG Audit Plc will be deemed to be re-appointed auditors of the Company for the current financial year.

Qualifying third party indemnities

The Articles of Association of the Company provide for the directors and officers of the Company to be indemnified in respect of liabilities incurred as a result of their office. Prudential plc also provides certain protections for its directors and senior managers of companies within the Prudential Group against personal financial exposure that they may incur in their capacity as such. These include qualifying third party indemnity provisions (as defined under section 309B of the Companies Act 1985) in force for the benefit of the directors of Prudential plc and of certain directors of associated companies (as defined under section 309A of the Companies Act 1985) at the time this directors' report was approved under section 234A of the Companies Act 1985 and during 2006.

On behalf of the board of directors.

Prudential Group Secretarial Services Limited
Company Secretary
22 March 2007

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2006

Long Term Business - Technical Account	Note	2006 £m	2005 £m
Earned premiums, net of reinsurance			
Gross premiums written	1	**4**	60
		4	60
Investment income	2	**944**	944
Unrealised (losses) / gains on investments		**(651)**	700
		293	1,644
Claims incurred, net of reinsurance			
Claims paid		**(921)**	(913)
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance	9	**605**	(405)
Change in technical provision for linked liabilities, net of reinsurance	9	**90**	(115)
		695	(520)
Net operating expenses			
- Acquisition costs		**(1)**	(1)
- Administrative expenses		**(15)**	(12)
- Investment expenses and charges		**(12)**	(9)
		(28)	(22)
Tax attributable to the long term business		**(11)**	(75)
Balance on the technical account – long term business		**32**	174

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 11 to 28 form an integral part of these financial statements.

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2006 (continued)

Non-Technical Account	Note	2006 £m	2005 £m
Balance on the long term business technical account		**32**	174
Tax credit attributable to the balance on the long term business technical account		**11**	75
Investment income	2	**62**	83
Unrealised (losses) /gains on investments		**(55)**	9
Investment management expenses		**(1)**	(1)
Profit on ordinary activities before tax		**49**	340
Tax on profit on ordinary activities	4	**(14)**	(101)
Retained profit for the financial year transferred to reserves	9	**35**	239

Statement of total recognised gains and losses

Year ended 31 December 2006

	2006 £m	2005 £m
Retained profit for the financial year	**35**	239
Total recognised gains and losses recognised since the last annual report	**35**	239

Reconciliation of movement in Shareholder's Funds

Year ended 31 December 2006

	2006 £m	2005 £m
Shareholders' capital and reserves at beginning of year	**1,590**	1,351
Retained profit for the financial year	**35**	239
Shareholders' capital and reserves at end of year	**1,625**	1,590

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 11 to 28 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2006

ASSETS	Note	**2006 £m**	2005 £m
Investments			
Land and buildings		**381**	348
Other financial investments		**12,913**	13,464
	7	**13,294**	13,812
Assets held to cover linked liabilities	8	**2,031**	2,125
Reinsurers' share of technical provisions			
Long term business provision	9	**4**	4
Technical provision for linked liabilities	9	**2**	2
		6	6
Debtors			
Tax recoverable		**10**	-
Other debtors		**21**	25
		31	25
Other assets			
Cash at bank and in hand		**123**	120
Prepayments and accrued income			
Accrued interest and rent		**221**	220
Total assets	1(b)	**15,706**	16,308

The accounting policies and notes on pages 11 to 28 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2006 (continued)

LIABILITIES	Note	2006 £m	2005 £m
Capital and reserves			
Called up share capital	14	**550**	550
Profit and loss account	9	**1,075**	1,040
Total shareholders' funds		**1,625**	1,590
Technical provisions			
Long term business provision	9	**11,323**	12,005
Claims outstanding	9	**23**	17
Technical provisions for linked liabilities	9	**2,033**	2,127
Provision for other risks and charges			
Deferred tax	11	**216**	206
Creditors			
Derivative liabilities		**44**	77
Amounts owed to credit institutions		**411**	218
Other creditors including taxation and social security	12	**31**	68
Total liabilities		**15,706**	16,308

The financial statements on pages 7 to 28 were approved by the board of directors on 22 March 2007.

N E T Prettejohn
Chairman

The accounting policies and notes on pages 11 to 28 form an integral part of these financial statements.

Prudential Annuities Limited

Accounting Policies

(a) Basis of preparation

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

The financial statements have been prepared in accordance with applicable accounting standards and with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 2005.

The Company has not presented a capital position statement with supporting disclosures under FRS 27 on the basis that the Company is more than 90 per cent owned within a group and the Company is included in the publicly available Prudential group financial statements which provide information on a group basis complying with this requirement. The process for setting assumptions and determining liabilities, as required to be disclosed by FRS 27, is described in note 10 of the financial statements (together with key assumptions).

Change in accounting policies

The Company has implemented the following accounting standards in preparing its results for the year ended 31 December 2006. These standards closely reflect the requirements of International Financial Reporting Standards (IFRS) and form part of the continuing implementation of IFRS in the UK.

FRS 23 "The effects of changes in foreign exchange rates", FRS 24 "Financial reporting in hyperinflationary economies", FRS 25 "Financial Instruments: Disclosures and Presentation" and FRS 26 "Financial instruments: Measurement"

These accounting standards are part of a package of standards comprising FRS 23, FRS 24, the disclosure requirements of FRS 25 and FRS 26. The Company adopted these standards on 1 January 2006. The presentation requirements of FRS25 were adopted by the Company from 1 January 2005.

The main impacts of the adoption of these standards are described below:

FRS 23 "The effects of changes in foreign exchange rates"

The adoption of this standard has no impact on the balance sheet or profit and loss account of the Company. However, certain changes have been made on the disclosures relating to foreign exchange differences as a result of adopting this standard.

FRS 24 "Financial reporting in hyperinflationary economies"

The adoption of this standard has no impact on the results of the Company.

FRS 25 "Financial instruments: disclosures and presentation"

FRS 25 is based on the text of IAS 32 "Financial instruments: disclosures and presentation" as at 31 March 2004, incorporating the revised version of IAS 32 issued by the IASB in December 2003 and includes amendments made by IFRS 4 "Insurance contracts".

Prudential Annuities Limited

Accounting Policies (continued)

(a) Basis of preparation (continued)

The disclosures required under FRS 25 are set out in Note 7. The Company has taken advantage of the provisions within FRS 25 that allows the comparatives not to be restated to comply with this standard in the first year of adoption.

FRS 26 "Financial instruments: measurement"

FRS 26 is based on the text of IAS39, "Financial instruments: recognition and measurement" as at 31 March 2004, incorporating the revised version of IAS39 issued by the IASB in December 2003 together with the amendments to IAS39 on "Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk" and those made by IFRS 4 "Insurance contracts".

As with FRS 25, the comparative information has not been restated to comply with this standard.

Certain provisions of the Statement of Recommended Practice, "Accounting for Insurance Business", issued in December 2005 (as amended in December 2006) by the Association of British Insurers ABI SORP ("the ABI SORP") relating to application of FRS 26 also became effective for the Company upon its adoption of FRS 26 in 2006. The principal effects of adopting FRS 26 arise in the Company's long-term business contracts and financial assets.

Long-term business

On adoption of FRS 26, the measurement basis of assets and liabilities of long term business contracts is dependent upon the classification of the contracts as either insurance contracts, if the level of insurance risk is significant, or investment contracts if the risk is insignificant. The Company's contracts are all classed as insurance contracts.

(b) Long term business

Annuity considerations are accounted for when due. Annuities are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid. Death claims and all other claims are accounted for when notified. Index linked business has been disclosed as linked for the purposes of these financial statements.

Investment income and realised and unrealised investment gains attributable to long-term business are credited to the long term business technical account.

The costs of acquiring new business, principally commission and certain costs associated with policy issue and underwriting which are not matched by policy charges, are written off in the year they are incurred.

Accounting Policies (continued)

(c) Investments

(i) *Land and buildings*
Land and buildings are valued annually by professional external valuers on an Fair Value basis, as defined in the Appraisal and Valuation Manual issued by the Royal Institute of Chartered Surveyors, in particular Practice Statement 3.2. No depreciation is provided on land and buildings, held for investment purposes, in accordance with Statement of Standard Accounting Practice 19, Accounting for Investment Properties.

On historical cost basis buildings are depreciated over 40 years. Leasehold buildings are depreciated over the 40 years or if the lease is less than 40 years over the length of the lease.

(ii) *Other financial investments valuation*
Listed investments are shown at fair value. Unlisted investments are valued on quotations provided by external fund managers, brokers, independent pricing services or values as determined by the directors.

(iii) *Realised gains and losses on investments*
Realised gains and losses on investments represent the difference between the value on disposal and the original cost.

(iv) *Unrealised gains and losses on investments*
Unrealised gains and losses on investments represent the difference between the fair value or directors' valuation (as appropriate) and the fair value at the previous balance sheet date or the original cost if acquired during the year.

An impact arising from the adoption of FRS 26 is in relation to recognition and measurement of financial instruments (other than long-term business contracts classified as financial instrument as described above). Upon initial recognition, financial investments are measured at fair value. Subsequently, the Company is permitted, subject to specific criteria, to designate its investments as either financial investments at fair value through profit and loss, financial investments held on an available-for-sale basis, financial investments held to maturity, or loans and receivables. The Company holds financial investments on the following bases:

(v) *Financial investments at fair value through profit and loss*
This comprises assets designated by management as fair value through profit and loss on inception. These investments and including all derivatives are valued at fair value with all changes thereon being recognised in the profit and loss account.

Under the previous UK GAAP, quoted financial investments are carried at market value at the mid-market prices. Upon the adoption of FRS 26, the Company uses bid prices to value its quoted financial investments.

(vi) *Loans and receivables*
This comprises investments that have fixed or determinable payments and are not designated as fair value through profit and loss or available-for-sale. These investments include loans secured by mortgages, deposits and other unsecured loans and receivables. These investments were held at fair value under the previous UK GAAP. Under FRS 26, these investments are carried at amortised cost using the effective interest method and subject to impairment reviews. The Company measures the amount of the impairment loss by comparing the amortised cost with the present value of its estimated future cash flows discounted at the original effective interest rate.

Prudential Annuities Limited

Accounting Policies (continued)

(d) Long term business provision

The long term business provision is determined by the Company's directors based on advice from the Company's actuarial function holder, who determined the provision using recognised actuarial methods, with due regard to the actuarial principles laid down in Directive 2002/83/EC. It is calculated initially on a statutory solvency basis to comply with the reporting requirements under the Financial Services and Markets Act 2000. The valuation is then modified to remove certain resilience, contingency and other reserves required by the Prudential Sourcebook for Insurers and the General Prudential Sourcebook issued by the Financial Services Authority.

The technical provisions are the discounted value of future claim payments, adjusted for investment expenses and future administration costs. Claim payments allow for the effects of mortality in line with the bases set out in Note 10. These bases have been derived from an analysis of recent population and internal mortality experience and include an allowance for improvements in mortality in the future.

The interest rates used for discounting claim payments are derived from the yield on the assets held and make allowance for potential defaults on those assets. Historical market rates of defaults have been investigated. The analysis takes into account credit rating, term to redemption and security. Using this information, default rates are derived appropriate to the assets within the portfolio. (See Note 10.)

(e) Cash flow statement

The Company has availed itself of the exemption from preparing a cash flow statement allowed under section 5(a) of Financial Reporting Standard Number 1, Cash Flow Statements, on the grounds that it is a wholly owned subsidiary of Prudential plc which publishes a consolidated cash flow statement incorporating the cash flows of the Company.

(f) Taxation

Tax is charged on all taxable profits arising in the accounting period.

Except where otherwise required by accounting standards, full provision for deferred tax without discounting is made for all timing differences which have arisen but not reversed at the balance sheet date.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2006

1. Segmental analysis

(a) Gross premiums written	**2006 £m**	2005 £m
Pension annuities:		
- Non-participating	**3**	35
- Linked	**1**	25
	4	60
Comprising:		
External direct premiums:		
- Immediate annuities	**2**	38
- Deferred annuities	**-**	22
	2	60
Reinsurance from a related party:		
- Immediate annuities	**2**	-
Total	**4**	60

All income is single premium business written in the United Kingdom. Group pension scheme buyouts included in external premiums are £1m (2005: £58m).

(b) Assets attributable to the long term business fund

Of the total assets shown on page 9, £14,624m (2005: £15,344m) is attributable to the long term business fund.

2. Investment income

	Long term business technical account		**Non technical account**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Income from land and buildings	**22**	22	**-**	-
Income from debt securities	**734**	754	**50**	42
Income from mortgage loans and other loans	**16**	18	**-**	-
Income from deposits with credit institutions	**11**	13	**1**	1
Income from other investments	**1**	-	**-**	-
Gains on the realisation of investments	**160**	137	**11**	40
	944	944	**62**	83

Notes to the financial statements for the year ended 31 December 2006 (continued)

3. Staff costs

The Company has no employees (2005: Nil). Included within net operating expenses are amounts paid in return for management services provided to the Company by other group companies.

4. Tax on profit on ordinary activities

(a) Analysis of charge in the period

	2006 £m	2005 £m
Current Tax		
UK Corporation tax on profits of the period	3	67
Adjustments in respect of previous periods	1	-
Deferred Tax		
Origination and reversal of timing differences	10	34
Tax on profits on ordinary activities	14	101

(b) Factors affecting tax charge for the period

	2006 £m	2005 £m
Profit on ordinary activities before tax	49	340
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2005: 30%)	14	101
Effects of		
Adjustments in respect of previous periods	1	-
Permanent difference	(1)	-
Timing differences		
Transfer to the non-technical account in excess of the statutory surplus	(9)	(34)
Capital allowances on items expensed in the accounts	(1)	-
Current tax charge for the period	4	67

5. Auditors' remuneration

Fees payable to KPMG for the audit of the Company's account were £86,875, (2005: £69,000). Fees payable to KPMG for other services pursuant to legislation, including the audit of the regulatory return were £28,669 (2005: £23,000).

Notes to the financial statements for the year ended 31 December 2006 (continued)

6. Directors' emoluments

During the year, the directors received the following emoluments in respect of work on behalf of the Company.

	2006 £	2005 £
Aggregate emoluments and non-pension benefits	**198,760**	150,744
	198,760	150,744

Five (2005: five) directors were entitled to shares under the Prudential's main long term incentive scheme. Four directors are entitled to retirement benefits under defined benefit schemes and one director participates in the defined contribution scheme.

The aggregate of emoluments and amount receivable under long term incentive schemes of the highest paid director included in the above figure was £79,451. During the year the highest paid director received shares under a long term incentive scheme.

7. Investments

	Cost		**Current Value**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Freehold land and buildings	**199**	198	**269**	252
Leasehold land and buildings	**81**	79	**112**	96
Equity securities	**287**	-	**361**	-
Debt securities and other fixed income securities	**10,890**	10,937	**11,858**	12,750
Derivative assets	**(8)**	(6)	**148**	143
Loans secured by mortgages	**179**	196	**179**	238
Other loans	**17**	-	**17**	-
Deposits with credit institutions	**350**	333	**350**	333
	11,995	11,737	**13,294**	13,812

The change in current value of investments included in the Profit and Loss account was a loss of £693m (2005: gain of £581m) analysed between a loss of £638m (2005: gain of £572m) included in the Long-term business technical account and a loss of £55m (2005: gain of £9m) included in the Non-technical account. The change in current value of £638m (2005: £572m) included a gain of £31m (2005: £49m) in respect of land and buildings, a gain of £36m (2005: loss of £7m) in respect of derivatives, a gain of £73m (2005 : nil) in respect of equity securities and a loss of £778m (2005: gain of £530m) in respect of debt securities.

Notes to the financial statements for the year ended 31 December 2006 (continued)

7. Investments (continued)

Amounts included above ascribed to listed investments:

	Current Value	
	2006 £m	2005 £m
Equity securities	**361**	-
Debt securities and other fixed income securities	**10,576**	11,421
	10,937	11,421

If the revalued land and buildings were stated on the historical cost basis, the amounts would be:

	Freehold and leasehold land and buildings	
	2006 £m	2005 £m
At cost	**280**	277
Aggregated depreciation	**(26)**	(24)
Net book value based on historical cost	**254**	253

(a) Financial instruments

(i) Designation and fair values

On application of FRS26 all financial assets of the Company are designated as either fair value through profit and loss or loans and receivables. Financial liabilities are designated as either fair value through profit and loss, amortised cost.

	Fair value through profit and loss	**Loans and receivables**	**Total carrying value**	**Fair value**
		2006 £m		
Financial Assets:				
Lands and buildings	381	-	381	381
Deposits with credit institutions	-	350	350	350
Equity securities	361	-	361	361
Debt securities	11,858	-	11,858	11,858
Loans and receivables:				
Loans secured by mortgages	-	179	179	211
Other loans	-	17	17	18
Derivatives assets	148	-	148	148
	12,748	**546**	**13,294**	**13,327**
Financial Liabilities:				
Derivative liabilities	44	-	44	44
	44	-	**44**	**44**

7. Investments (continued)

(a) Financial instruments (continued)

(i) Designation and fair values (continued)

As at 31 December 2006, £124m of convertible bonds were included in debt securities and £nil were included in borrowings.

The interest income on financial assets not at fair value through profit and loss was £26m for the year ended 31 December 2006.

There is no interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2006.

(ii) Determination of fair values

The fair values of quoted investments are based on current bid prices, where appropriate. If the market for a financial asset is not active, fair value is established using quotations from independent third parties such as brokers or by using valuation techniques. The valuation techniques include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and enterprise valuation and may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments.

The fair value estimates are made at a specific point in time, based upon available market information and judgements about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holding of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses. In some cases the fair value estimates cannot be substantiated by comparison to independent markets, nor can the disclosed value be realised in immediate settlement of the financial instrument.

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 rate of discount used was the market rate of interest.

The estimated fair value of derivative instruments reflects the estimated amount the Group would receive or pay in an arm's length transaction. The amount is mainly determined using quotations from independent third parties or valued internally using standard market practices. In accordance with the Company's risk management framework, all internally generated valuations are subject to independent assessment against external counterparties' valuations.

The fair value of other financial liabilities is determined using discounted cash flows of the amounts expected to be paid.

Notes to the financial statements for the year ended 31 December 2006 (continued)

7. Investments (continued)

(a) Financial instruments (continued)

(iii) Use of valuation techniques

At 31 December 2006, the Company held investments with a fair value of £1,509m (2005: £1,535m) which were measured in full or in part using valuation techniques. The majority of these assets are debt securities, which are valued internally using market standard practices. These practices are based on assessing credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. In accordance with the Company's risk management framework, all internally generated valuations are subject to independent assessment. Changing any one of the underlying assumptions used in determining the fair value would not have a significant impact on the value of the assets.

The total amount of the change in fair value estimated using valuation techniques, including valuation techniques based on assumptions not wholly supported by observable market prices or rates, recognised in the profit and loss account in 2006 was a loss of £57m.

(b) Market risk

(i) Interest rate risk

The following table shows an analysis of the classes of financial assets and liabilities with direct exposure to interest rate risk. Each applicable class of the Company's assets or liabilities are analysed between those exposed to fair value interest rate risk, cash flow interest rate risk and those with no direct interest rate risk exposure.

	Fair value interest rate risk	Cash flow interest rate risk	Not directly exposed to interest rate risk	Total
		2006 £m		
Financial Assets:				
Lands and buildings	-	-	381	381
Deposits with credit institutions	31	319	-	350
Equity securities	-	-	361	361
Debt securities	11,689	35	134	11,858
Loans and receivables:				
Loans secured by mortgages	179	-	-	179
Other loans	17	-	-	17
Derivatives assets	-	87	61	148
	11,916	441	937	13,294
Financial Liabilities:				
Derivative liabilities	4	36	4	44
	4	36	4	44

Notes to the financial statements for the year ended 31 December 2006 (continued)

7. Investments (continued)

(b) Market risk (continued)

(i) Interest rate risk (continued)

The following table details the effective interest rates for applicable classes of financial assets and liabilities not held at fair value through profit and loss, notably financial assets designated as loans and receivables and liabilities held at amortised cost.

	Balance of financial instruments not at fair value through profit and loss 2006 £m	Range of effective interest rates applicable as at 31 Dec 2006 %
Financial Assets		
Deposits with credit institutions	350	0.00% - 5.31%
Loans and receivables:		
Loans secured by mortgages	179	0.00% - 12.04%
Other loans	17	6.04% - 11.28%
Total	546	

In relation to interest rate exposure, the following table sets out the earlier of contractual maturities and repricing dates for applicable classes of financial instruments.

2006	Less than 1 year	1 to 5 years	5 to 10 years	10 to 15 years	15 to 20 years	Over 20 years	No stated maturity	Total carrying value
				2006 £m				
Financial Assets								
Lands and buildings	-	-	-	-	-	-	381	381
Deposits with credit institutions	350	-	-	-	-	-	-	350
Equity securities	-	-	-	-	-	-	361	361
Debt securities	143	673	1,213	2,434	2,047	4,930	418	11,858
Loans and receivables:								
Loans secured by mortgages	8	21	1	62	54	33	-	179
Other loans	-	-	-	-	17	-	-	17
Derivatives assets	-	-	-	-	2	146	-	148
	501	694	1,214	2,496	2,120	5,109	1,160	13,294
Financial Liabilities								
Derivative liabilities	-	-	-	28	3	13	-	44
	-	-	-	28	3	13	-	44

Notes to the financial statements for the year ended 31 December 2006 (continued)

7. Investments (continued)

(b) Market risk (continued)

(ii) Currency risk

As at 31 December 2006, the Company held 2.54% and 26.50% of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency.

The exchange risks inherent in these exposures are mitigated through the use of derivatives, mainly forward currency contracts.

(c) Derivatives

The Company uses various currency derivatives in order to limit volatility due to foreign currency exchange fluctuations arising on securities denominated in currencies other than Sterling. In addition, total return swaps and interest rate swaps are held for efficient portfolio management.

The Company is party to a number of currency and interest rate swap agreements. Currency swap agreements involve the exchange of payments in different currencies over the life of the agreement. The Company enters into currency swap transactions to hedge foreign currency risk on overseas investments. Interest rate swap agreements involve the exchange of fixed and floating payments over the life of the agreements without an exchange of the underlying principal amount. The Company enters into interest swap transactions to assist in the matching of contractual liabilities.

These currency and interest rate swap agreements are accounted for on a fair value basis, consistent with the assets and liabilities hedged.

The notional amount of the derivatives was as follows at 31 December 2006.

	Notional amount on which future payments are based	
	Asset 2006 £m	**Liability 2006 £m**
Cross-currency swaps	372	300
Inflation swaps	174	174
Interest rate swaps	1,112	1,112

(d) Concentration of credit risk

The geographical concentration of credit risk, stated in terms of financial assets held as at 31 December 2006 is as follows:

	£m
UK	9,012
Rest of Europe	1,751
North America	1,252
Other	1,279
Total	13,294

7. Investments (continued)

(e) Collateral under derivatives transactions

The amount of assets accepted as collateral in respect of OTC (over-the-counter) derivatives transaction was £72m for the year ended 31 December 2006.

(f) Impairment of financial assets

During the year no significant amounts have been recognised for impairment losses.

(g) Risk management

The Company's business involves the acceptance and management of risk. The Company has in place a risk management process, which is undertaken in accordance with the Group Risk Framework adopted by the Prudential Group in 1999.

A number of risk factors affect the Company's operating results and financial condition. The financial risk factors affecting the Company include the effects of market risk, credit risk and liquidity risk on the financial instruments of the Company.

The Company uses derivatives to facilitate efficient portfolio management or to reduce investment risk. The most widely used derivatives by the Company are interest rate, currency and inflation-linked swaps.

It is the Company's policy that cash or corresponding assets cover amounts at risk through derivative transactions. Derivative financial instruments used to facilitate efficient portfolio management and for investment purposes are carried at fair value with changes in fair value included in the profit and loss account. The Company has not applied hedge accounting to its derivatives.

<u>Market risk</u>

Market risk is the risk that future changes in market prices may make a financial instrument less valuable. The primary market risks that the Company faces is interest rate risk because most of its assets are investments that are bonds, mortgages or cash deposits, the values of which are subject to interest rate risk.

The Company has some liabilities that contain guaranteed returns which generally will be supported by fixed income investments.

<u>Credit risk</u>

Credit risk is the risk that a counterparty or an issuer of securities, which the Company holds in its asset portfolio, defaults or another party fails to perform according to the terms of the contract. The Company's long-term fund holds large amounts of interest rate sensitive investments that contain credit risk on which a certain level of defaults is expected. These expected losses are considered when the Company determines the crediting rates, deposit rates and premium rates for the products that will be supported by these assets. Certain over-the-counter derivatives contain a credit risk element that is controlled through evaluation of collateral agreements and master netting agreements on interest rate and currency swaps. The Company is also exposed to credit-related losses in the event of non-performance by counterparties.

Notes to the financial statements for the year ended 31 December 2006 (continued)

7. Investments (continued)

(g) Risk management (continued)

Liquidity risk

Liquidity risk is the risk that the Company may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates. Liquidity management in the Company seeks to ensure that, even under adverse conditions, the Company has access to the funds necessary to cover surrenders, withdrawals and maturing liabilities.

In practice, most of the Company's assets are marketable securities. This, combined with the fact that a large proportion of the liabilities contains discretionary surrender values or surrenders charges, reduces the liquidity risk.

8. Assets held to cover linked liabilities

	Cost		Current Value	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Assets held to cover linked liabilities	**1,599**	1,651	**2,031**	2,125

The change in current value of assets held to cover linked liabilities included in the Long-term business technical account was a loss of £13m (2005: gain of £128m).

9. Reserves and policyholder liabilities (net of reinsurance)

	Claims Outstanding £m	**Technical provision for linked liabilities £m**	**Long term business provision £m**	**Profit and loss account £m**
Balance at 1 January 2006	17	2,125	12,001	1,040
Movement in:				
- Effect of FRS 26 on technical provisions at 1 January 2006	-	(4)	(77)	-
- Movement in technical provisions for the year	6	(90)	(605)	-
- Profit and loss account	-	-	-	35
Balance at 31 December 2006	**23**	**2,031**	**11,319**	**1,075**

9. Reserves and policyholder liabilities (net of reinsurance) (continued)

Of the balance on the profit and loss account of £1,075m (2005: £1,040m), £515m (2005: £558m) is distributable to the shareholder. The remaining balance on the profit and loss account is not distributable due to the need to maintain the required margin of solvency, as computed under the rules of the FSA's Interim Prudential Sourcebook, the Integrated Prudential Sourcebook for Insurers (in force until 30 December 2006) and the Prudential Sourcebook for Insurers and General Prudential Sourcebook (both effective from 31 December 2006).

10. Long term business provisions

The Company's liabilities are for contracts that provide individual immediate and bulk immediate and deferred annuities.

The immediate annuities are either fixed or retail price-index linked (referred to as RPI), where annuity payments are guaranteed from the outset. These products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products.

The deferred annuities are also either fixed or RPI linked, both during deferment and in payment.

The primary risks to the Company are therefore longevity, investment and credit risk.

The Company's fixed-increase annuities may incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The Company's RPI annuity contracts provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK Retail Prices Index, in some cases subject to pre-defined minima and maxima.

For bulk annuity business the Company manages the assets and accepts the liabilities of a company pension scheme, to the extent to which they are funded, usually when it is wound up by the employer.

The provision is the present value of the annuity payments and expenses. The principal assumptions used in the calculation are set out below.

Mortality

Mortality assumptions are set in light of recent population and internal experience. The mortality assumptions used are percentages of standard actuarial mortality tables with an allowance for future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives an additional age adjustment is made. The percentages of the standard table used are selected according to the source of business. The range of percentages used is set out in the table below:

Notes to the financial statements for the year ended 31 December 2006 (continued)

10. Long term business provisions (continued)

	2006		2005	
	Males	Females	Males	Females
In payment	106% - 126% PNMA00 (C = 2000) with medium cohort improvement table with a minimum annual improvement of 1.25%	84% - 117% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 0.75%	93% - 107% PMA92 (C = 2004) with medium cohort improvement table with a minimum annual improvement of 1.25%	84% - 108% PFA92 (C = 2004) with 75% of medium cohort improvement table with a minimum annual improvement of 0.75%
In deferment	AM92 – 4 years	AF92 – 4 years	AM92 – 4 years	AF92 – 4 years

The change in mortality assumptions resulted in no change in liabilities.

Interest rate

The valuation interest rates comply with the requirements of Rule 1.2.33R of the Prudential Sourcebook for Insurers except that:

- additional margins for prudence required in setting the valuation interest rate for the valuation of liabilities for statutory solvency purposes have been removed

- the company is required, by an order issued under section 148 of the Financial Services and Markets Act 2000, to calculate the valuation rate of interest by reference to the aggregate yield on the assets rather than the market weighted gross redemption yield which is normally required by the Valuation Rules.

The valuation interest rates are adjusted to reflect investment management expenses and the risk of default in the assets. The default adjustment is reviewed annually to reflect the assets held.

Other assumptions

An allowance is made for expenses, including investment management expenses, following an investigation into the Company's costs.

The allowance for asset defaults in the derivation of the valuation interest is unchanged from the allowance made at 31 December 2005.

Notes to the financial statements for the year ended 31 December 2006 (continued)

11. Provision for deferred tax

	2006 £m	2005 £m
Unrealised gains on investments	1	1
Transfer to the non-technical account in excess of the statutory surplus	216	207
Capital allowances on items expensed in the accounts	(1)	(2)
Undiscounted provision for deferred tax	216	206

	2006 £m	2005 £m
Deferred tax liability at start of year	206	172
Deferred tax charged in profit and loss account	10	34
Deferred tax liability at end of year	216	206

12. Creditors

All creditors are payable within a period of five years.

Other creditors including taxation and social security	2006 £m	2005 £m
Taxation	6	45
Other creditors	25	23
	31	68

13. Bank current accounts

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

14. Called up share capital

The Company's authorised share capital is £800,000,000 (2005: £800,000,000) comprising 800,000,000 ordinary shares of £1 each, of which 550,000,000 (2005: 550,000,000) have been issued and fully paid.

15. Related party transactions

The Company has taken advantage of the exemption under paragraph 3(c) of Financial Reporting Standard Number 8 from disclosing transactions with other subsidiary undertakings of the Prudential Group. There were no other transactions with related parties.

Notes to the financial statements for the year ended 31 December 2006 (continued)

16. Immediate and ultimate parent company

The immediate parent company is The Prudential Assurance Company Limited. The ultimate parent company is Prudential plc, which is the only parent company which prepares group financial statements. Copies of these financial statements can be obtained from the Company Secretary, Laurence Pountney Hill, London, EC4R 0HH.

Statement of directors' responsibilities in respect of the directors' report and the financial statement

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards.

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

N E T Prettejohn
Chairman

22 March 2007

Independent Auditor's report to the member of Prudential Annuities Limited

We have audited the financial statements of Prudential Annuities Limited for the year ended 31 December 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Reconciliation of movements in Shareholders Funds and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities on page 29 the company's directors are responsible for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Director's Report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
8 Salisbury Square
London EC4Y 8BB
22 March 2007