Registered No: 15454

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Annual Report and Accounts 2006

Final Version
Dated 27 March 2007

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Incorporated and registered in England and Wales. Registered no. 15454

Registered office: Laurence Pountney Hill, London EC4R 0HH

CONTENTS

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Directors

M E Tucker (Chairman)
D J Belsham
P A J Broadley
N E T Prettejohn
G Shaughnessy

Secretary

S Windridge

Auditor

KPMG Audit Plc, London

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2006

Principal activity

The principal activity of the Company is transacting long-term insurance business in the United Kingdom. The Company also owns a number of insurance subsidiary undertakings and a branch in Hong Kong that transact insurance business in the United Kingdom and overseas. These activities will continue in 2007.

The Company itself is a wholly owned subsidiary undertaking of another company registered in England and Wales and therefore group financial statements and a group business review are not prepared. Accordingly, the financial statements and the following business review present information about the Company as an individual undertaking and are not consolidated.

Business review

Market review and strategy

The Company's long-term products consist of life insurance, pension products and pension annuities. In common with other UK long-term insurance companies, the Company's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. Depending upon the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies. With-profits policies are supported by the with-profits sub-fund and can be single or regular premium. The return to shareholders on virtually all with-profits products is in the form of a statutory transfer to the Company's shareholders' funds which is analogous to a dividend from the Company's long-term fund and is dependent upon the level of bonuses credited or declared on policies in that year. With-profits policyholders currently receive 90 per cent of the distribution from the with-profits sub-fund as bonus additions to their policies and shareholders receive 10 per cent as a statutory transfer. There is a substantial volume of non-participating business in the with-profits sub-fund and its wholly owned subsidiary Prudential Annuities Limited (PAL), which is closed to new business; profits from this business accrue to the with-profits sub-fund. The Company also writes non-participating business, the profit on which accrues solely to shareholders, and this business is written in the Company's non-profit sub-fund.

The UK retirement market continues to remain attractive with an ageing population driving demand for pre and post-retirement products. This positive demographic trend, together with an increasing concentration of wealth in the hands of those approaching retirement or already retired, will continue to fuel the opportunity for financial provision in retirement.

While many UK consumers remain overly-indebted and are not saving enough for retirement, with a backdrop of reduced State and employer provision, they are increasingly keen to take control of their financial affairs.

The impact of A-Day in April 2006, the implementation of pensions simplification legislation, initially dampened new business in certain areas, particularly in the annuities market, but subsequently led to considerable market growth in individual pensions, Self Invested Personal Pensions (SIPPs) and annuities. Much of the market growth in pensions savings reflected recycling of money as consumers consolidated existing pensions arrangements to one provider.

The wholesale annuity and risk management market experienced increased competition over 2006, as short-term demand slowed and several new entrants started to participate. However, the long-term potential in this market remains considerable, with approximately £900 billion of accessible liabilities held across a number of market segments.

During 2006, the Company has continued to target capital efficient returns through selective participation within its chosen markets, retirement income, wealth and health and wholesale. Going forward the Company will focus on maximising value for shareholders by building on its longevity and asset allocation strengths, as well as utilising its brand strength with older customers, targeting their specific retirement needs. This focus on maximising value will be achieved alongside a programme of cost cutting initiatives for both new business and the Company's back book to ensure greater operating efficiencies are achieved.

The Company's operations are structured into three business units:

- Retail Retirement
- Mature Life & Pensions
- Wholesale

Retail Retirement focuses on savings and income for those customers nearing or in retirement. The Company's strategy in Retail Retirement is to continue to drive growth in its annuities business, building on the pipeline of vestings business from its pensions book.

The new Flexible Protection Plan was launched in July to the direct channel and to a select group of intermediaries specialising in the protection market. This innovative new protection product is designed to pay critical illness claimants earlier and more often than traditional protection products with, on average, four times as many serious illnesses covered. Payments are based on severity levels and multiple claims for the same or new illness are possible. Early results have been encouraging.

The Company has exited the unprofitable front end commission markets for individual pensions and will transition from front end commission unit-linked bonds, particularly moving away from those areas of low persistency. Instead, the Company will focus on new low risk multi-asset products which utilise the Company's strengths in asset allocation and use 'factory gate pricing' (negotiated between customer and adviser with separate advice costs). These products will target the significant number of retail investors approaching retirement who have substantial assets outside personal or corporate pension plans, or have investments in poorly performing funds, and require inflation protection.

The Company remains committed to the corporate pensions market despite the low returns achieved to date. Its tightened focus will be on larger schemes with better than expected persistency and a clear cost reduction programme which together will deliver an improved internal rate of return.

The Company will continue to deliver embedded value through the Mature Life and Pensions business area. It has an aggressive target to reduce per policy unit processing costs and is evaluating the best route for achieving this which will include one or all of internal cost cutting, further off-shoring or out-sourcing.

The Company believes there is potential within the wholesale market from which it is well positioned to benefit given its financial strength, strong brand and outstanding life fund investment returns. The Wholesale business area chooses not to chase headline growth but instead maintains a strict focus on value.

The Company distributes products through both direct and intermediated channels. The direct channel will focus on capturing internal pension vestings via a specialist face-to-face direct salesforce. The indirect channel will distribute products through retail intermediaries, strategic partners and through Employee Benefit Consultants and consulting actuaries. Participation within the intermediary market will be selective, focusing on those advisers who focus on value and building client relationships.

The Company has a significant strategic relationship with Royal Bank of Scotland. In 2002, Prudential transferred its UK personal lines general insurance business to Royal Bank of Scotland and formed a strategic alliance with Churchill to offer Prudential branded general insurance products for which the Company receives a distribution fee.

Risks & uncertainties

The Company is a wholly owned subsidiary within the Group, Prudential plc and as such forms a part of the overall risk management process of the Group. A significant part of the Group's business involves the acceptance and management of risk. The Group has a Risk Framework requiring all businesses and functions within the Group i.e. including the Company, to establish processes for identifying, evaluating and managing key risks. The system of internal control is an essential and integral part of the risk management process. As part of the annual preparation of its business plan, all of the Group's businesses and functions are required to carry out a review of risks including an assessment of the impact and likelihood of key risks and effectiveness of the controls in place to manage them. The assessment is reviewed regularly throughout the year and all businesses and functions within the Group are required to confirm annually that they have undertaken risk management. Actual performance is regularly monitored against the business plans. Detailed procedures are laid down in financial and actuarial procedure manuals. The insurance operations of the Group, such as the Company, also prepare a financial condition report.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2006 (continued)

The key risks and uncertainties affecting the Company are as follows:

1) The Company's business is inherently subject to market fluctuations and general economic conditions.

The Company's business is inherently subject to market fluctuations and general economic conditions. This is because a significant part of the Company's shareholders' profit is related to bonuses for policyholders declared on its with-profits products, which are broadly based on historic and current rates of return on equity, property and fixed income securities, as well as the Company's expectations of future investment returns.

The Company is susceptible to general economic conditions and changes in investment returns, which can change the level of demand for the Company's products. Past uncertain trends in economic and investment climates which have adversely affected the Company's business and profitability could be repeated. This adverse effect would be felt principally through reduced investment returns and credit defaults. In addition, falling investment returns could impair the Company's operational capability, including its ability to write significant volumes of new business. The Company, in the normal course of business enters into a variety of transactions, including derivative transactions with counterparties. Failure of any of these counterparties, particularly in conditions of major market disruption, to discharge their obligations, or where adequate collateral is not in place, could have an adverse impact on the Company's results.

2) The Company conducts its business subject to regulation and associated regulatory risks, including the effects of changes in laws, regulations, policies and interpretations and accounting standards in the markets in which it operates.

Changes in government policy, legislation or regulatory interpretation applying to companies in the financial services and insurance industries, which in some circumstances may be applied retrospectively, may adversely affect the Company's product range, distribution channels, capital requirements and, consequently reported results and financing requirements.

The EU is also currently reviewing future solvency requirements (Solvency II) with a draft directive expected in mid 2007 for implementation by member states not earlier than 2010. Inconsistent application of these directives by regulators in different EU member states may place the Company at a competitive disadvantage to other European financial services groups active in the UK.

In the UK several proposed and potential regulatory changes could have significant effect on the types of products Prudential provides to its customers and intermediaries and how those products are priced, distributed and sold. These include the Financial Services Authority's (FSA) move towards principles-based regulation, the FSA's Treating Customers Fairly initiative, the FSA's review of retail distribution, the proposed regulatory change affecting the UK pensions market, the implementation of the Markets in Financial Instruments Directive (MiFID) and the Solvency II directive.

The UK operates investor compensation schemes that requires mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant, circumstances could arise where the Company, along with other companies, may be required to make additional material contributions.

Any further changes or modification to Financial Reporting Standards may require a change in the reporting basis of future results or a restatement of reported results.

3) The resolution of issues affecting the financial services industry could have a negative impact on the Company's results or on its reputation or on its relations with current and potential customers.

The Company is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business. This could be a review of business sold in the past under previously acceptable market practices at the time such as the requirement to provide redress to certain past purchasers of pension and mortgage endowment policies and regulatory reviews on products sold and industry practices, including in the latter case business it has closed.

In the UK regulators are increasingly interested in the approach that product providers use to select third-party distributors and to monitor sales made by them.

4) Litigation and disputes may adversely affect the Company's profitability and financial condition.

The Company is, and in the future may be, subject to legal actions and disputes in the ordinary course of its insurance, investment management and other business operations. These legal actions and disputes may relate to aspects of the Company's businesses and operations that are specific to the Company, or that are common to companies that operate in the UK markets. Legal actions and disputes may arise under contracts, regulations or from a course of conduct taken by the Company, and may be class actions. Although the Company believes it has adequately reserved in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such reserves are sufficient. Given the large or indeterminate amounts of damages sometimes sought, and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on the Company's results of operation or cash flows.

5) The Company's business is conducted in a highly competitive environment with developing demographic trends and the Company's continued profitability depends on management's ability to respond to these pressures and trends.

The market for UK financial services is highly competitive with several factors affecting the Company's ability to sell its products and its continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historic bonus levels, developing demographic trends and customers' appetite for certain savings products. The Company's principal competitors in the life market include many of the major retail financial services companies including, in particular, Aviva, Legal & General, HBOS and Standard Life.

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

6) Downgrades in the Company's financial strength and credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties.

The Company's financial strength and credit ratings, which are intended to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in its products, and as a result its competitiveness. Changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or the Company's financial condition. Downgrades in ratings could have an adverse effect on the Company's ability to market products and retain current policyholders. In addition, the interest rates the Company pays on its borrowings are affected by its debt credit ratings, which are in place to measure the Company's ability to meet its contractual obligations. The Company believes the credit rating downgrades it experienced in 2002 and 2003, together with the rest of the UK insurance industry, and in 2006 by Standard & Poor's to bring Prudential into line with the standard rating agency notching between operating subsidiary financial strength rating and the credit rating for other European insurance holding companies, have not to date had a discernible impact on the performance of its business.

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

Operational risks are present including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. The Company's business is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. In addition several operations are outsourced, including some processing and IT functions. In turn, the Company is reliant upon the operational processing of its outsourcing partners. Further, because of the long-term nature of much of the Company's business, accurate records have to be maintained for significant periods. The Company's systems and processes incorporate controls which are designed to manage and mitigate the operational risks associated with its activities. For example, any weakness in the administration systems or actuarial reserving process could have an impact on its results during the effective period. The Company has not experienced or identified any operational risks in its systems or processes during 2006, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

8) Adverse experience against the assumptions used in pricing products and reporting business results could significantly affect the Company's results of operations.

The Company needs to make assumptions about a number of factors in determining the pricing of its products and for reporting the results of its long-term business operations. For example, the assumption that the Company makes about future expected levels of mortality is particularly relevant for its annuity business. In exchange for a premium equal to the capital value of their accumulated pension fund, pension annuity policyholders receive a guaranteed payment, usually monthly, for as long as they are alive. The Company conducts rigorous research into longevity risk, using data from its substantial annuitant portfolio. As part of its pension annuity pricing and reserving policy, the Company assumes that current rates of mortality continuously improve over time at levels based on adjusted data from the Continuous Mortality Investigations (CMI) medium cohort table projections as published by the Institute and Faculty of Actuaries. If mortality improvement rates significantly exceed the improvement assumed, the Company's results of operations could be adversely affected.

A further example is the assumption that the Company makes about future expected levels of the rates of early termination of products by its customers (persistency). This is particularly relevant to its lines of business other than its annuity business. The Company's persistency assumptions reflect recent past experience for each relevant line of business. Any expected deterioration in future persistency is also reflected in the assumption. If actual levels of future persistency are significantly lower than assumed (that is, policy termination rates are significantly higher than assumed), the Company's results of operations could be adversely affected.

In common with other industry participants, the profitability of the Company's businesses depends on a mix of factors including mortality and morbidity trends, policy surrender rates, investment performance, unit cost of administration and new business acquisition expense.

9) Adverse experience in other parts of the Group could significantly affect the Company's results

Group risk is present from the consequences of risks arising from other parts of the Group in addition to those risks arising from the Company's own activities. The independent capitalisation of the Company as well as the risk management processes and internal control mechanisms within the Company ensure Group Risk is appropriately managed.

Performance and measurement

The results of the Company for the year as set out on pages 11 to 13, show a profit on ordinary activities before tax of £424m (2005:£257m). The increase of 65% on 2005 is mainly attributable to the positive impact of changes in Financial Services Authority reserving requirements for protection and unit-linked products and, as a consequence of the impact of higher terminal bonuses and higher investment returns on with-profits business. Significantly better investment returns have been achieved in 2006 compared with the sector average returns of: Balanced Managed Funds; Distribution Funds; and Cautious Managed Funds. The Company's with-profits products have also significantly out-performed against cash and building society accounts.

The shareholders' funds of the Company total £3,131m (2005:£2,778m).

Sales on an APE basis (Regular Premiums plus 1/10th Single Premiums) are up from £694m in 2005 to £783m in 2006. The Company's financial strength and continuing outstanding life fund investment returns have been well received by both customers and advisers having a positive impact on with-profit product sales. Corporate pension sales have increased due to the continuing shift from defined benefit to defined contribution schemes and the impact of A-day. The removal of uncertainty around A-day pension changes also increased activity in individual annuity sales in the second half of 2006. Sales of unit-linked bonds are down on 2005 as the Company continues to focus on value over volume in this market; a large percentage of this market is financially unattractive with high up-front commission costs and poor forward-looking persistency due to high churn. For this reason the Company is targeting higher value intermediaries.

The PAC's long-term fund remains very strong. On a realistic valuation basis, with liabilities recorded on a market consistent basis, the free assets are valued at approximately £8.7 billion at 31 December

2006, before a deduction for the risk capital margin. The fund is rated AA+ by Standard & Poor's, Aa1 by Moody's and AA+ by Fitch Ratings.

The with-profits sub-fund delivered a pre-tax investment return of 12.4 per cent in 2006, and over the last five years the fund has achieved a total return of 63.8 per cent against 41.1 per cent for the FTSE 100 total return and 50.2 per cent for the FTSE All-Share (Total Return) index (figures are to 31 December 2006, before tax and charges). Much of this excellent investment performance was achieved through the active asset allocation of the fund. As part of its asset allocation process, the Company constantly evaluates prospects for different markets and asset classes. During the year the Company decreased its exposure to equities while increasing its exposure to corporate bonds and alternative assets, reflecting the Company's view that increased diversification in the assets of the with-profits sub-fund was appropriate.

The table below shows the change in the investment mix of the Company's with-profits fund:

	2006	**2005**	**2004**
	per cent	**per cent**	**per cent**
UK equities	36	40	33
International equities	17	19	15
Property	15	15	18
Bonds	25	21	29
Cash and other assets classes	7	5	5
Total	**100**	**100**	**100**

Corporate responsibility

The Company is a wholly owned subsidiary within Prudential plc and corporate responsibility (CR) at Prudential is not an optional extra, it is fundamental to how the Group and its businesses operate, and is a philosophy that is now embedded within the business. It is recognised that stakeholders increasingly support those companies that define and exhibit sound values around trust, ethics and environmental responsibility. It is also believed that performance in key areas of conduct such as corporate governance, environmental management and employment practices can have a significant impact on its financial performance. The Group, of which the Company is a part, has developed a Group Governance Framework which is underpinned by a Group Governance Manual and associated processes. This encompasses all key policies and procedures for example the Group Code of Business Conduct, the CR policy and Health and Safety Policy. "Treating Customers Fairly" is a key ethic on which the Company conducts its business.

There is also a Corporate Responsibility Committee which is Group-wide and has responsibility for reviewing business conduct and social and environmental policy. A CR team develops the Group's strategy, provides training across the Group and works closely with the businesses and functions, of which the Company is a part, to provide advice and to ensure that core values are maintained. The CR team also assists with the adaptation of Group-wide initiatives to meet local needs.

Outlook & forthcoming objectives

The Company will continue to focus on profitable opportunities, which deliver capital efficient returns. In addition, it will continue to pursue profitable opportunities in its chosen product areas and distribution channels in 2007.

The Company expects the UK financial services environment to remain favourable, with a forecast growth rate in the medium and long term savings market of around 5-10 per cent over the next few years.

The Company and Equitable Life ('Equitable') have announced on 15 March 2007 that they have reached agreement in principle for the Company to acquire Equitable's portfolio of in-force with-profits annuities. The transaction is subject to a vote among Equitable's policyholders as well as regulatory and Court approval. Under the terms of the agreement, this portfolio of with-profits annuities would transfer into the Company's with-profits fund. The Company would assume direct responsibility for the management of these policies and payment to these annuitants after the transfer is completed under a Part VII scheme. The intention is for the Equitable book to transfer to the Company by the end of 2007.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2006 (continued)

This transaction is one of the first of its kind and demonstrates the Company's ability to grow its with-profits fund to create value for its policyholders and shareholders while providing Equitable policyholders with improved prospects and greater security by being part of one of the largest and financially strongest funds in the UK which has delivered excellent investment returns over many years.

Subsidiary undertakings and branches

Particulars of the Company's principal subsidiary undertakings at 31 December 2006 are included in note 15. At 31 December 2006 the Company had a branch outside the United Kingdom in Hong Kong.

With-profits governance

The Company produces an annual report, which is available on request, setting out how it has complied with its Principles and Practices of Financial Management (PPFM).

The Board has established a with-profits committee (WPC), made up of three members (each of whom is external and independent of the Company). The WPC provides the Board with an independent assessment of the way in which the Company manages its with-profits business, its compliance with the PPFM, and how the Company balances the rights and interests of policyholders and shareholders in relation to its with-profits funds. The WPC has the right, if it wishes, to make a statement to with-profits policyholders in addition to the Company's report described above.

The Company has a With-Profits Actuary who has the specific duty to advise the Board on the application of discretion in relation to with-profits business; and an Actuarial Function Holder who will provide the Board with all other actuarial advice. Both of these are Financial Services Authority approved roles.

Post balance sheet events

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

Accounts

The state of affairs of the Company at 31 December 2006 is shown in the balance sheet on pages 15 and 16. The profit and loss account appears on pages 11 to 13.

Share Capital

Changes in the Company's share capital during 2006 are shown in note 22.

Dividends

An interim dividend of £248m (2005: £382.7m) on the ordinary shares was paid on 8 May 2006. The directors have not declared a final dividend on the ordinary shares for 2006 (2005: £Nil).

A dividend on the A preference shares of £26,994 was paid on 8 May 2006 (2005: £30,461). No dividend was paid on any other preference shares.

Payment policy

The Company does not follow any code or standard on payment practice with its suppliers but it is the policy of the Company to agree terms of payment when orders for goods or services are placed and to pay in accordance with those terms. Trade creditor days, based on the ratio of amounts which were owed to trade creditors at the year end to the aggregate of the amounts invoiced by trade creditors during the year, were 22 days (2005: 21 days).

Directors

The present directors are shown on page 1.

Mr K Coleman was appointed as a director of the Company on 4 May 2006 and resigned as a director of the Company on 15 December 2006. Mr G Shaughnessy was appointed as a director of the Company on 12 June 2006. Mr T J W Tookey, Mr R C Ramsden and Mr A D Briggs resigned as directors of the Company on 16 March 2006, 31 May 2006 and 2 October 2006 respectively. There were no other

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2006 (continued)

changes during the year. Since the year end, Mrs R Harris resigned as a director of the Company on 2 February 2007.

Directors' interests

Of the directors in office at the end of the year, Mr M E Tucker, Mr P A J Broadley and Mr N E T Prettejohn were also directors of Prudential plc and their interests are shown in the annual report and accounts of that company.

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 shares awarded under the Prudential Employee Share Trust in which the shares are held in trust and released at the designated release date, and in shares held in relevant Prudential Share Incentive Plans:

	1.1.2006 or at date of appointment if later	**31.12.2006**
D J Belsham	118,546	110,569
R Harris	58,205	38,320
G Shaughnessy	3,676	3,805

(b) in conditional awards that have been made under the Prudential Restricted Share Plan, in which 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:

	1.1.2006 or at date of appointment if later	**31.12.2006**
D J Belsham	60,740	75,168
R Harris	41,853	66,401
G Shaughnessy	-	-

(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:

	1.1.2006 or at date of appointment if later	**31.12.2006**
D J Belsham	47,258	47,258
R Harris	40,067	40,067
G Shaughnessy	-	-

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

	1.1.2006 or at date of appointment if later	Granted in 2006	Exercised in 2006	Lapsed or cancelled In 2006	**31.12.2006**
D J Belsham	6,153	-	-	-	6,153
R Harris	6,153	-	-	-	6,153
G Shaughnessy	4,892	-	-	-	4,892

The other directors in office at the end of the year also had interests in the 50p shares of Egg plc as follows

	1.1.2006 or at date of appointment if later	**31.12.2006***
D J Belsham	1,410	-
R Harris	470	-
G Shaughnessy	-	-

* During the year, the minority interest of Egg plc was acquired by Prudential plc on the basis of 0.2237 new Prudential plc shares for each Egg share held.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2006 (continued)

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) was granted or exercised any right to subscribe for shares in, or debentures of, any group company during the year.

Political and Charitable Donations

During 2006 £214,512 was donated to the Przezornosc Foundation (2005: £212,991). This is broken down as follows: Education £125,112; Social and Welfare £75,854; Cultural £13,546.

During 2006 the Hong Kong branch made donations of £50,025 (2005: £44,000) as follows: £42,133 was donated to English Adventure, Hong Kong Blood Cancer Fund £2,654, World Emergency Relief £1,746 and Central Rat Race £3,492. This is broken down as follows: Education £42,133; Social and Welfare £7,892.

No donations were made for political purposes.

Disclosure of information to auditor

The directors who held 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 he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Financial instruments

The Company is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The financial risk factors affecting the Company include market risk, credit risk and liquidity risk. Information on the financial risk management objectives and policies of the Company and the exposure of the Company to the financial risk factors is given in note 32 (F) on pages 54 to 55.

Further information on the use of derivatives by the Company is provided in note 32 (C) on page 53.

Auditor

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

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 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.

S Windridge
Secretary
27 March 2007

Profit and Loss Account for the year ended 31 December 2006

Note	General Business Technical Account	2006 £m	2005 £m
1b	Gross premiums written		
	Continuing operations	**24**	23
	Outward reinsurance premiums	**(5)**	(5)
	Premiums written, net of reinsurance	**19**	18
	Change in the provision for unearned premiums		
	Gross amount	**(1)**	(1)
	Earned premiums, net of reinsurance	**18**	17
	Claims paid		
	Gross amount	**(25)**	(45)
	Reinsurers' share	**10**	18
	Claims paid, net of reinsurance	**(15)**	(27)
	Change in provision for claims		
	Gross amount	**17**	47
	Reinsurers' share	**(7)**	(32)
	Net of reinsurance	**10**	15
	Claims incurred, net of reinsurance	**(5)**	(12)
4	Net operating expenses	**(12)**	(8)
7	Change in the equalisation provision	**3**	9
1b	**Balance on the general business technical account**	**4**	6
	Analysis:		
	Continuing operations	2	-
8	Operations in run-off	**2**	6
		4	6

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

Note	Long-term Business Technical Account	2006 £m	2005 £m
1a	Gross premiums written	**5,814**	6,377
	Outward reinsurance premiums	**(1,689)**	(1,760)
	Earned premiums, net of reinsurance	**4,125**	4,617
2	Investment income	**9,633**	6,794
	Unrealised gains on investments	**1,819**	9,557
	Claims paid		
	Gross amount	**(9,547)**	(8,878)
	Reinsurers' share	**903**	993
	Claims paid, net of reinsurance	**(8,644)**	(7,885)
	Change in provision for claims		
	Gross amount	**(17)**	(37)
	Reinsurers' share	**2**	(1)
	Claims incurred, net of reinsurance	**(8,659)**	(7,923)
	Change in long-term business provision		
	Gross amount	**(3,101)**	(14,373)
	Reinsurers' share	**975**	993
		(2,126)	(13,380)
	Change in technical provision for linked liabilities	**(495)**	(814)
	Change in other technical provisions, net of reinsurance	**(2,621)**	(14,194)
4	Net operating expenses	**(910)**	(873)
5	Investment expenses and charges	**(336)**	(340)
6	Tax attributable to the long-term business	**(666)**	(941)
	Actuarial gain on pension schemes	**288**	118
	Transfer (to) from the fund for future appropriations	**(2,370)**	3,444
	Balance on the long-term business technical account	**303**	259

All premiums and the balance on the long-term business technical account relate to continuing operations.

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

Note	**Non-Technical Account**	**2006 £m**	2005 £m
	Balance on the general business technical account	**4**	6
	Balance on the long-term business technical account	**303**	259
6	Tax credit (charge) attributable to the balance on the long-term business technical account	**101**	(11)
1a	Balance on the long-term business technical account before tax	**404**	248
2	Investment income	**27**	37
	Unrealised profit on portfolio investments	**17**	3
	Other income	**29**	22
13	Amortisation of goodwill	**(33)**	(33)
	Other charges	**(24)**	(21)
1c	Total profit on other activities	**16**	8
9	(Loss) on disposal of related undertakings	**-**	(5)
	Profit on ordinary activities before tax	**424**	257
6	Tax (charge) credit on profit on ordinary activities	**(102)**	4
	Profit for the financial year	**322**	261

There is no material difference between the results for the current year and the previous year as described in the profit and loss account and the results on an unmodified historical cost basis. Accordingly, a note of the historical cost profits and losses for the year is not given.

Statement of Total Recognised Gains and Losses for the year ended 31 December 2006

Note		2006 £m	2005 £m
	Profit for the financial year	**322**	261
	Other recognised gains and losses:		
23	Increase in surplus on revaluation of investments in shareholder subsidiaries	**256**	358
	Exchange adjustments	**(4)**	3
	Actuarial gain/(loss) on pension scheme, net of related deferred tax	**11**	(6)
	Total recognised gains relating to the financial year	**585**	616
	Effect of FRS26 on the opening balance sheet	**(13)**	
	Total gains and losses recognised since last annual report	**572**	

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2006

Note		2006 £m	2005 £m
	Total recognised gains relating to the financial year	**585**	616
	Dividends	**(248)**	(383)
	Increase in share capital	**29**	186
	Net movement in shareholders' funds	**366**	419
	Shareholders' funds at beginning of year as originally reported	**2,778**	2,359
	Effect of FRS26 on the opening balance sheet	**(13)**	-
	Shareholders' funds at beginning of year as restated	**2,765**	2,359
	Shareholders' funds at end of year	**3,131**	2,778
	Included in Shareholders' funds are aggregate net foreign exchange differences as follows:		
	Aggregate net foreign exchange differences included in opening Shareholders' funds	**(2)**	2
	Net foreign exchange differences for the year	**(2)**	1
	Aggregate net foreign exchange differences included in closing Shareholders' funds	**(4)**	3

Balance sheet as at 31 December 2006

Note	**Assets**	**2006 £m**	2005 £m
	Called up share capital not paid	**-**	34
13	Intangible assets		
	Licence	**138**	147
	Goodwill	**30**	63
		168	210
	Investments		
14	Land and buildings	**10,947**	10,848
15	Investments in group undertakings and participating interests	**6,465**	5,413
16	Other financial investments	**80,726**	77,487
		98,138	93,748
17	Assets held to cover linked liabilities	**7,863**	7,262
18	Reinsurers' share of technical provisions		
	Provision for unearned premiums	**2**	2
	Long-term business provision	**10,851**	9,877
	Claims outstanding	**38**	43
	Technical provisions for linked liabilities	**3,819**	3,531
		14,710	13,453
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	**82**	119
	Intermediaries	**7**	8
	Debtors arising out of reinsurance operations	**11**	27
19	Other debtors	**327**	286
		427	440
	Other assets		
20	Tangible assets	**8**	12
	Cash at bank and in hand	**937**	672
		945	684
	Prepayments and accrued income		
	Accrued interest and rent	**420**	392
	Deferred acquisition costs		
	General business	**4**	4
	Long-term business	**167**	174
	Accrued external dividends receivable	**110**	110
	Other prepayments and accrued income	**81**	129
		782	809
	Total assets (excluding pension asset)	**123,033**	116,640
10	Pension asset (net of related deferred tax)	**51**	-
21	**Total assets (including pension asset)**	**123,084**	116,640

Balance sheet as at 31 December 2006 (continued)

Note	Liabilities	2006 £m	2005 £m
	Capital and reserves		
22	Share capital	**291**	262
23	Revaluation reserve	**1,313**	1,057
23	Other reserves	**535**	535
23	Profit and loss account	**992**	924
1c	Shareholders' funds - equity interests	**3,131**	2,778
24	Fund for future appropriations	**13,990**	11,817
	Technical provisions		
	Provision for unearned premiums	**11**	12
30	Long-term business provision	**89,671**	86,843
25	Claims outstanding	**576**	579
7	Equalisation provision	**1**	4
	Unearned revenue provision	**57**	-
	Total technical provisions	**90,316**	87,438
	Technical provisions for linked liabilities	**11,682**	10,793
	Deposits received from reinsurers	**18**	25
	Provisions for other risks and charges		
6	Deferred taxation	**2,019**	1,880
	Other	**8**	-
		2,027	1,880
	Creditors		
	Creditors arising out of direct insurance operations	**77**	58
	Creditors arising out of reinsurance operations	**22**	9
	Amounts owed to credit institutions	**60**	-
26	Other creditors including taxation and social security	**1,613**	1,384
27	Preference shares	**1**	1
		1,773	1,452
	Accruals and deferred income	**147**	163
	Total liabilities (excluding pension liabilities)	**123,084**	116,346
10	Pension liabilities (net of related deferred tax)	**-**	294
	Total liabilities (including pension liabilities)	**123,084**	116,640

The accounts on pages 11 to 55 were approved by the Board of directors on 27 March 2007.

M E Tucker
Chairman

Accounting Policies

A. 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.

Amendment to FRS 17 "Retirement benefits"

An amendment to FRS 17 "Retirement Benefits" was issued in December 2006 which takes effect for accounting periods beginning on or after 6 April 2007, with early adoption encouraged. The Company has early adopted the amendment to FRS 17 issued in December 2006 in preparing the results for the year ended 31 December 2006. The main effect of this amendment is to replace the existing disclosure requirements of FRS 17 with those of IAS 19 "Employee Benefits". The amended disclosures are shown in Note 10. The measurement change from this amendment where pension assets should now be valued at current bid value rather than mid market values has an immaterial effect on the Company's Report and Accounts.

FRS 20 "Share-based Payment"

The Company adopted FRS 20 "Share-based Payment" in 2006 which requires all share-based payments to be accounted for on a fair value basis. This standard applies to the share award and option plans offered to the staff employed by the Company. The impact on the profit and loss account from the adoption of this standard is immaterial and there is no net impact on shareholders' funds. Disclosures relating to the share award and option plans for the staff of the Company are given in Note 10.

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".

The disclosures required under FRS 25 are set out in Note 32. 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.

Accounting Policies (continued)

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. Insurance contracts and investment contracts with discretionary participation features are to be accounted for under previously applied UK GAAP, which is as set out in the ABI SORP. Discretionary participation features represent the contractual right to receive additional benefits as a supplement to guaranteed benefits. The Company's insurance contracts and investment contracts with discretionary participation features are primarily with-profits and other protection type policies.

For investment contracts without discretionary participation features, FRS 26 and where the contract includes an investment management element, the provisions of the ABI SORP apply measurement principles to the assets and liabilities attaching to the contract that diverge from those applied under the previous UK GAAP. The changes primarily arise in respect of deferred acquisition costs, deferred income reserves and provisions for future expenses commonly called "sterling reserves".

The investment contract without discretionary participation features classification applies primarily to certain unit-linked and similar contracts written by the Company.

Under previous UK GAAP, acquisition costs were deferred with amortisation on a basis commensurate with the anticipated emergence of margins under the contract. Under FRS 26 and the ABI SORP, the costs potentially capable of deferral are limited to incremental costs which are directly attributable to securing investment management contracts. These are recognised as an asset that represents the entity's contractual right to benefit from providing investment management services which is amortised as the entity recognises the related revenue. Deferred acquisition costs are amortised to the long-term business technical account in line with service provision.

Deferred income provisions for front-end fees and similar arrangements are required to be established for these contracts with amortisation over the expected life of the contract in line with service provision.

Sterling reserves are not permitted to be recognised under FRS 26 for investment contracts.

A further feature is that investment contracts without discretionary participation features are closer in nature to a deposit style arrangement between the investors and the Company. Premiums and withdrawals for these contracts are recorded within the balance sheet as a movement on the investors liability and the long-term business technical account reflects the fee income, expenses and taxation on the contract. The provisions for investment contracts without discretionary participation features are included in Technical Provisions for Linked Liabilities in the balance sheet. FRS26 impacts the following captions in the Long Term Business Technical Account: gross premiums written, outwards reinsurance premiums, claims paid gross amount, claims paid reinsurers' share, net operating expenses, investment income (inclusion of policy fees for administration and management services) and change in technical provisions for linked liabilities.

Financial Investments

The other main 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 instruments 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:

(i) 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.

Accounting Policies (continued)

Under the previous UK GAAP, quoted financial investments were 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.

(ii) 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 loans to policyholders 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.

The effects of the changes in accounting policies from the adoption of the standards above on opening shareholders' funds and profit and loss account are as follows:

	Profit and loss account £m	Shareholders' funds £m
31 December 2005 as previously published	924	2,778
Effect of adoption of FRS 26:		
Unit-linked contracts	(8)	(8)
Valuation of quoted securities at bid valuation	(2)	(2)
Valuation of loans at amortised cost	-	-
Fair valuation of derivative which has not been included at fair value under the previous UK GAAP	(3)	(3)
1 January 2006 (including FRS 26 adjustments)	911	2,765

No quantitative details of the effects of the adoption of these standards on the results of the Company for the year ended 31 December 2006 have been given as it is not practical to do so.

B. Basis of Preparation

The financial statements are prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985. The financial statements comply with applicable accounting standards and the ABI SORP, and have been prepared under the historical cost accounting rules, modified to include the revaluation of investments.

As the Company is a wholly owned subsidiary undertaking of another company registered in England and Wales, group financial statements are not prepared. Accordingly, the financial statements present information about the Company as an individual undertaking and are not consolidated.

The Company has taken advantage of the exemption under FRS1 (Revised) from preparing a cash flow statement. 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.

C. Long-term Business

Technical account treatment - 2005

Premiums and annuity considerations for conventional with-profit policies and other protection type life insurance policies are accounted for when due. For unit linked business and unitised with-profit policies, premiums are accounted for when the liabilities arising from the premiums are created. Premiums exclude any taxes or duties based on premiums. Pensions annuity contracts that vest during the year are included in claims incurred and premium income at the annuity purchase price.

Maturity claims are accounted for on the policy maturity date. Annuities are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid and death claims when notified.

Accounting Policies (continued)

The costs of acquiring new insurance contracts, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges are amortised against margins in future revenues on the related insurance contracts for non-profit business.

Bonus additions made to policies are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred.

Profits comprise actuarial surpluses allocated to shareholders adjusted, other than for with-profits business, for the deferral of acquisition costs and movements in the shareholders' interest in reserves held within long-term funds. For with-profits business, unappropriated surplus is carried forward in the fund for future appropriations and no allocation is made to the shareholders. There is no deferral of acquisition costs for with-profits business.

The fund for future appropriations comprises amounts arising in relation to participating policies and other non-linked policies, the allocation of which to policyholders or to shareholders has not been determined at the balance sheet date.

Technical account treatment - 2006

For 2006, upon the adoption of FRS 26 and the related provisions within the ABI SORP, the recognition basis in the technical account remains the same except for investment contracts which do not contain discretionary participation features, where the accounting reflects the deposit nature of the arrangement, with premiums and claims reflected as deposits and withdrawals taken directly to the balance sheet.

Investment contracts without discretionary participation features are required to be accounted for as financial liabilities with FRS 26 and where relevant, the provisions of the ABI SORP, in respect of the attaching investment management features of the contracts. The Company's investment contracts primarily comprise certain unit-linked savings contracts.

Incremental, directly attributable acquisition costs relating to the investment management element of these contracts are capitalised and amortised in line with related revenue. If the contracts involve up-front charges, this income is also deferred and amortised through the technical account in line with contractual service provision.

The assumptions used to calculate the long-term business provisions are described in note 30.

In response to change to FSA reserving regulations as detailed in the Financial Services Authority Policy Statement PS06/14, the following changes have been made to the calculation of the long term business provisions for business in the non-profit sub-fund:

(i) for linked insurance business, the existing non-unit reserve has been replaced by a non-unit reserve at an individual policy level which provides for directly attributable expenses only, and a separate reserve for non-attributable expenses which is calculated at a homogenous risk group level. Each homogenous risk group includes policies with similar expense risk characteristics.

(ii) prudent lapse rates have been assumed in the calculation at the homogenous risk group level of the non-unit reserves for linked insurance business, and the reserves for most non-linked protection insurance business excluding credit life. The non-unit reserves at a homogenous risk group level have been set to be sufficient to avoid future valuation strains, so that future contributions will not be necessary to maintain the appropriate level of reserves on the basis of the assumptions made.

The revised FSA rules have not been adopted for business either in SAIF or in the with-profits sub-fund.

The impact of adopting this change has been to reduce the long term business provisions by £58m and reduce the deferred acquisition cost asset by £19m.

The Company adopted FRS 27 on 1 January 2005 which impacted the basis of reporting for the with-profits business provisions. FRS 27 is underpinned by the FSA's Peak 2 realistic basis of reporting. Realistic reserves are established using best estimate assumptions, and taking into account the firm's regulatory duty to treat its customers fairly.

Accounting Policies (continued)

The FSA realistic value of liabilities is calculated as:

(i) a with-profits benefits reserve (WPBR) plus
(ii) future policy related liabilities (FPRL) plus
(iii) the realistic current liabilities of the fund

The WPBR is the main component of the product related liability, and is mainly determined using a retrospective asset share calculation.

Asset shares are calculated by rolling up the premiums paid, less expenses and charges using the actual investment returns earned on the with-profits fund. The assumptions used within the asset share calculations are consistent with those that are actually used to determine policyholders' bonuses. A number of adjustments are made to reflect future expected policyholder benefits and other outgoings. For certain classes of business including conventional with-profits whole life, industrial branch and many pension contracts (which have capped charges) a prospective bonus reserve valuation is performed instead, valuing future claims and expenses using the expected future bonus rates.

The FPRL includes a market consistent valuation of the costs of guarantees, options and smoothing. This is determined using stochastic modelling. The FPRL also includes other liabilities such as tax on shareholder transfers and enhancements to policy benefits arising from the distribution of surplus from non-profit business written within the with-profits fund or from the Company's subsidiary, Prudential Annuities Limited (PAL). For SAIF, the FSA realistic liability calculation requires that all of the surplus within the fund is distributed to policyholders and therefore the FPRL is increased up to the point where the fund has no working capital.

The FSA realistic value of liabilities is adjusted in accordance with FRS 27 to remove the present value of shareholder transfers and related tax. Shareholder transfers are recognised as a liability for the purposes of FSA regulatory returns, but for accounting purposes under FRS 27, consistent with the current basis of financial reporting, shareholders transfers are recognised only on declaration.

The reported assets include the Company's interest in its subsidiary, PAL, adjusted from the value reported in the FSA realistic balance to reflect differences in the provisioning and capital requirements between the accounting and FSA realistic basis.

The reported assets exclude the present value of future profits of PAL and of non-profit business written within the with-profit funds. Similarly, that part of these future profits which is included in the FSA realistic value of liabilities is excluded from the FPRL under FRS 27.

D. General Business

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

Premiums are accounted for when risks are assumed. Premiums are shown gross of commission and exclude any taxes or duties based on premiums. In determining the result, the proportion of premiums written relating to periods of risk beyond the year end is carried forward to subsequent accounting periods as unearned premiums, calculated on a daily basis, so that earned premiums relate to risks carried during the accounting period. A similar treatment is applied to acquisition expenses.

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

An unexpired risks provision is established for any excess of expected claims and deferred acquisition costs over unearned premiums and investment return. The assessment of expected claims has regard to claims experience up to the end of the accounting period. No specific provision is made for major events occurring after this date.

An equalisation provision has been established in accordance with the requirements of the Prudential Sourcebook for Insurers in order to reduce the impact of claims volatility.

Transactions in respect of general business operations in run-off are accounted for within the general business technical account.

Accounting Policies (continued)

E. Investments

Investment income and realised and unrealised gains in respect of long-term business are included in the long-term business technical account. Other investment income and realised gains and, except in respect of shareholder investments in subsidiaries, unrealised gains are included in the non-technical account.

Realised gains are determined as the difference between net proceeds on disposal and the purchase price. Movements in unrealised gains comprise the change in the value of investments held at the balance sheet date and the reversal of unrealised investment gains and losses recognised in earlier accounting periods in respect of investment disposals.

Shareholder investments that undertake long-term business are shown at current values using embedded values as determined in accordance with the European Embedded Value principles issued by the CFO Forum of European Insurance Companies in May 2004. Investments in other subsidiaries are valued at net asset value. The movement in values is taken to the revaluation reserve, other than permanent diminution in value, which is taken to the non-technical account. Investments in participating interests are carried at fair value.

Other investments are shown at market value. The Company uses current bid prices to value its quoted investments. Actively traded investments without quoted prices are valued using external broker bid prices. If there is no active established market for an investment, the Company applies an appropriate valuation technique such as discounted cash flow technique. Loans and receivables are carried at amortised cost using the effective interest rate method.

Properties are valued annually by professional external valuers at market value as defined in the Appraisal and Valuation Manual issued by the Royal Institute of Chartered Surveyors in particular Practice statement 3.2. In accordance with SSAP 19, no depreciation is provided on investment properties as the directors consider that to depreciate them would not give a true and fair view.

In accordance with the Companies Act 1985 Schedule 9A paragraph 65d, there is a requirement to show the net book value on a historical cost basis of properties in a note to the accounts. For this purpose properties are depreciated over forty years. Leasehold properties are depreciated over forty years, or if the lease is less than forty years, over the length of the lease.

F. Tax

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.

G. Foreign Currencies

Foreign currency revenue transactions are translated at average exchange rates for the year. Foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences on long-term business and on net investments in foreign enterprises less matching borrowings are taken to reserves. Other exchange differences are included in the profit and loss account.

H. Tangible Assets

Tangible assets, principally fixtures and fittings, building improvements, computer equipment and software development expenditure, are capitalised and depreciated by equal annual instalments over their estimated useful lives. Fixtures and fittings and building improvements are depreciated over ten years, computer hardware over five years and software over three years.

I. Pension Costs

The Company applies the requirements of FRS 17 "Retirement Benefits" as amended December 2006. The Prudential Group operates a number of defined contribution and defined benefit pension schemes and a portion of these defined benefit pension schemes’ surplus or deficits is attributed to the Company. Further details are disclosed in note 10. Contributions in respect of defined contribution schemes are recognised when incurred.

Accounting Policies (continued)

The assets and liabilities of the defined benefit pension schemes of the Prudential Group are subject to a full triennial actuarial valuation using the projected unit method. PSPS is the largest defined benefit scheme and accounts for 88% of the liabilities of the Prudential Group's defined benefit schemes under FRS 17. The difference between the fair value of the scheme assets and the actuarial value of the scheme liabilities is a surplus or deficit on the scheme which is recognised on the balance sheet.

The aggregate of the actuarially determined service cost of the currently employed personnel, the unwind of discount on liabilities at the start of the period, less the expected investment return on the scheme assets at the start of the reporting period are recognised in the profit and loss account. The actuarial gains and losses which arise from assumptions, the difference between actual and expected investment return on the scheme assets, and experience gains and losses on liabilities are recognised in the statement of total recognised gains and losses in respect of the portion attributed to the Company's shareholder's funds, and the long-term technical account, in respect of the portion attributable to the Company's with-profits fund.

J. Intangible Assets

Intangible assets, including goodwill representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired is capitalised in the balance sheet at cost, and amortised through the profit and loss account on a straight line basis over its useful economic life. The gain or loss on subsequent disposal of a subsidiary will include any attributable unamortised goodwill.

Notes on the financial statements

1. Segmental analysis

(a) Long-term business

Premiums and profit	**Gross premiums written**		**Balance on the technical account before tax**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
United Kingdom	**4,776**	5,384	**368**	216
Hong Kong	**807**	667	**36**	30
France	**231**	326	**-**	2
	5,814	6,377	**404**	248

New business	**Regular premiums**		**Single premiums**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
United Kingdom	**219**	204	**3,851**	3,511
Hong Kong	**94**	77	**355**	289
France	**26**	-	**231**	326
	339	281	**4,437**	4,126

Single premiums include UK Department of Work and Pensions rebates business and increments under existing group pension schemes. Regular premiums are determined on an annualised basis.

New business premiums include those contracts excluded from premium income in the 2006 technical account under FRS26 and the ABI SORP (as amended in December 2006). These are investment contracts without discretionary participation features and carry no significant insurance risk.

Analysis of premium income	**2006 £m**	2005 £m
Gross written premiums:-		
Direct	**5,584**	6,049
Reinsurance accepted	**230**	328
	5,814	6,377
Analysis of gross direct premiums:-		
Individual business	**4,621**	5,188
Group contracts	**963**	861
	5,584	6,049
Regular premiums	**2,095**	2,248
Single premiums	**3,489**	3,801
	5,584	6,049
Participating contracts	**3,843**	3,615
Non-participating contracts	**1,300**	1,233
Linked long-term contracts (excluding investment contracts without discretionary participation features for 2006)	**441**	1,201
	5,584	6,049
United Kingdom	**4,776**	5,382
Hong Kong	**807**	667
France	**1**	-
	5,584	6,049

Net reinsurance income

Net reinsurance income in respect of long-term business for the year ended 31 December 2006 was £477m (2005: £1,261m).

Notes on the financial statements (continued)

1. Segmental analysis (continued)

(b) General business

Premiums and underwriting result		Gross premiums written		Underwriting result	
		2006 £m	2005 £m	**2006 £m**	2005 £m
Continuing operations	Hong Kong	**24**	23	**2**	-
Operations in run-off	United Kingdom	**-**	-	**2**	6
		24	23	**4**	6

Analysis of technical account	Gross Premiums Written		Gross Premiums Earned		Gross Claims Incurred		Gross Operating Expenses		Reinsurance Balance	
	2006 £m	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m
Motor										
-third party liability	**-**	-	**-**	**-**	**-**	**-**	**-**	-	**-**	(2)
-other classes	**1**	1	**1**	1	**2**	(3)	**1**	1	**2**	-
Marine, aviation and transport	**-**	-	**-**	-	**2**	(12)	**2**	**-**	**-**	(9)
Fire and other damage	**4**	4	**3**	4	**2**	(3)	**-**	(8)	**2**	(4)
Other	**19**	18	**19**	17	**2**	16	**9**	7	**(3)**	(3)
	24	23	**23**	22	**8**	(2)	**12**	-	**1**	(18)

The geographical analyses of long-term and general business premiums are based on the territory of the operating unit assuming the risk. Premiums by territory of risk are not materially different.

(c) Shareholders' other income and funds

Shareholders' other income and shareholders' funds, taking into account the location of business operations of subsidiaries, relate to the following countries:-

	Shareholders' other income		Shareholders' funds	
	2006 £m	2005 £m	**2006 £m**	2005 £m
United Kingdom	**(10)**	4	**1,959**	1,745
Singapore	**12**	-	**964**	876
Taiwan	**-**	1	**67**	67
Other countries	**14**	3	**141**	90
	16	8	**3,131**	2,778

Notes on the financial statements (continued)

2. Investment income

	Long- term business		Non-technical account	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Income from:				
Group undertakings	**57**	41	**36**	4
Other investments				
Land and buildings	**658**	713	**-**	-
Listed investments	**3,067**	2,670	**4**	5
Unlisted investments	**130**	164	**-**	-
Other investments	**411**	457	**(7)**	18
	4,323	4,045	**33**	27
Gains (losses) on the realisation of investments	**4,521**	3,184	**(6)**	10
Exchange gains (losses)	**755**	(435)	**-**	-
Fees for policy administration and asset management services arising from unit-linked investment contracts	**34**	-	**-**	-
	9,633	6,794	**27**	37

3. Bonuses

Bonuses added during the year are included in the change in the long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses was £3,072m (2005: £2,505m).

4. Net operating expenses

	Long-term business		General business	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Depreciation	**4**	5	**-**	-
Acquisition costs	**562**	729	**7**	7
Change in deferred acquisition costs	**29**	(14)	**-**	-
Administrative expenses	**306**	144	**5**	1
Amortisation of licence (Note 13)	**9**	9	**-**	-
	910	873	**12**	8

Acquisition costs include commissions in respect of long-term direct insurance business of £412m (2005: £552m) and general direct insurance business of £6m (2005: £6m).

No exchange differences have been credited/(charged) to administrative expenses.

5. Investment expenses and charges

	Long-term business		Non-technical account	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Investment management expenses	**297**	292	**-**	-
Interest on bank borrowings	**39**	48	**-**	-
	336	340	**-**	-

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.

Notes on the financial statements (continued)

6. Tax

a) Tax charged/(credited)

	Long-term funds		Shareholders' Profits	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Current Tax				
UK corporation tax	**466**	427	**21**	10
Double tax relief	**(35)**	(21)	**(11)**	(2)
Overseas tax	**59**	46	**2**	1
Adjustments in respect of prior year	**4**	(98)	**(13)**	1
Total current tax	**494**	354	**(1)**	10
Deferred tax				
Origination and reversal of timing differences	**162**	587	**-**	(3)
Adjustments in respect of prior year	**10**	-	**2**	-
Total deferred tax	**172**	587	**2**	(3)
Shareholders' attributable tax				
Current	**-**	-	**76**	(18)
Deferred	**-**	-	**25**	7
Total shareholders' attributable tax			**101**	(11)
Tax charge (credit) on profit on ordinary activities	**666**	941	**102**	(4)

b) Factors affecting tax charge for the period

	2006 £m	2005 £m
Profit on ordinary activities before tax	**424**	257
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30 per cent (2005: 30 per cent)	**127**	77
Permanent differences	**(3)**	-
Adjustment to current tax in respect of previous periods	**(13)**	(68)
Adjustment to deferred tax in respect of previous periods	**(2)**	-
Amortisation of goodwill not tax effective	**10**	10
Different tax bases of long-term insurance (current and deferred)	**(13)**	(28)
Effect of short term timing differences	**(26)**	2
Effect of double taxation relief	**(6)**	(1)
Franked investment income	**(3)**	-
Tax taken to reserves	**(1)**	-
Extra group relief on Prudential Health Limited losses	**5**	-
Current tax charge for the period	**75**	(8)

Notes on the financial statements (continued)

c) Balance Sheet	**Attributable to Long-term funds**		**Attributable to Shareholders' funds**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Provision for Deferred Tax				
Accelerated capital allowances	**5**	3	**(1)**	(1)
Policy reserves	**61**	30	**-**	-
Short term timing differences	**(32)**	(23)	**(7)**	(11)
Unrealised gains	**2,140**	2,024	**-**	-
Deferred acquisition costs	**(147)**	(142)	**-**	-
Undiscounted provision for deferred tax liability	**2,027**	1,892	**(8)**	(12)
Deferred tax liability at start of the period	**1,892**	1,322	**(12)**	(8)
Effect of FRS26 on opening balance sheet	**2**	-	**-**	-
Deferred tax credited to reserves	**-**	2	**-**	(1)
Deferred tax charged (credited) in technical/ non-technical account for the period	**133**	568	**4**	(3)
Deferred tax liability at end of the period	**2,027**	1,892	**(8)**	(12)

The deferred tax liability relating to the Pension Asset attributable to the Company of £1m (2005: £41m deferred tax asset) has been netted off against the Pension Asset on the balance sheet. The movement in this deferred tax liability has been included in the tax charge (credit) within the technical, non-technical account and statement of total recognised gains and losses.

7. Equalisation provision

An equalisation provision has been established in accordance with the requirements of the Prudential Sourcebook for Insurers. The provision, which is in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, is required by Schedule 9A of the Companies Act 1985 to be included within technical provisions in the balance sheet, notwithstanding that it does not represent a liability at the balance sheet date. This has had the effect of reducing shareholders' funds by £1m (2005: £4m). The movement in the equalisation provision during the year resulted in an increase in the general business technical account result and the profit before taxation of £3m (2005: £9m). However an IBNR (Incurred but not reported) provision has been maintained.

8. Operations in run-off

Operations in run-off comprise UK personal and commercial lines general insurance business.
The profit and loss account includes the following amounts in respect of these operations:

	2006 £m	2005 £m
Claims incurred, net of reinsurance		
Claims paid	**(7)**	(28)
Change in provision for claims	**11**	24
Total	**4**	(4)
Net operating expenses	**(4)**	-
Change in the equalisation provision	**2**	10
Technical result	**2**	6
Investment return	**-**	4
Operating profit before tax	**2**	10

During 2005, the Company entered into a Solvent Scheme of Arrangement under Section 425 of the Companies Act 1985, in respect of certain closed Marine and London Market business. All claims lodged by creditors by the Scheme submission date have now been settled, and related claims provisions in these financial statements have been released. In accordance with the terms of the Scheme claims notified after the final claims submission date are not valid, however an IBNR reserve has been maintained to meet legal fees incurred repudiating late reported claims and to meet claims from countries outside the jurisdiction of the Scheme.

Notes on the financial statements (continued)

9. Acquisition and disposal of subsidiaries and participating interests

On 21 December 2006 the Company purchased Prudential (AN) Limited for £27.9m and Prudential Holborn Life Limited for £49.0m from a fellow subsidiary of Prudential plc.

On 31 October 2006 Pru Limited was liquidated at cost for £0.1m.

On 23 December 2005 the Company's investment in The Standard Trust Limited was transferred at net asset value (£165m) to Holborn Finance Holding Company. As the value of the investment had been previously revalued the transaction generated a realised loss and an unrealised gain of £5m.

10. Information on staff and pension costs

The average number of persons employed by the Company During the year was:	**2006**	2005
United Kingdom	**109**	11
Hong Kong	**678**	643
	787	654

The costs of employment were:	**2006 £m**	2005 £m
Wages and salaries	**24**	19
Other pension costs in respect of defined contribution schemes (see below)	**1**	1
	25	20

Defined Benefit Pension Schemes

The majority of UK Prudential staff, are members of the Prudential Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (PSPS). This scheme is primarily a defined benefit scheme but no employees with employment offers after 31 July 2003 are eligible for membership of the defined benefit section of the Scheme. At 31 December 2006, on the FRS 17 "Retirement Benefits" (FRS 17) basis of valuation, PSPS accounts for 88% (2005: 89%) of the aggregate liabilities of the Prudential Group's defined benefit schemes. There is also a smaller defined benefit scheme, Scottish Amicable Pension Scheme (SAPS) in which the Company staff participate.

For the purposes of preparing consolidated financial statements, the Prudential Group applies IFRS basis accounting including IAS 19 "Employee Benefits" (IAS 19). However, individual company accounts of the parent, Prudential plc and the Company continue to apply UK GAAP. For 2006, this includes the early adoption of the Amendment to FRS 17 issued in December 2006 in the Company's financial statements which aligns the FRS 17 disclosures with IAS 19.

During 2005, the allocation of surpluses or deficits attaching to PSPS and SAPS between Prudential plc and the Company's shareholders' funds and unallocated surplus of the with-profits fund was clarified. The surpluses and deficits of the schemes have been apportioned based on the weighted cumulative activity attaching to the contributions paid to the schemes in the past. Prior to 2005, 80% of the deficit has been attributed to the Company's with-profits fund and 20% to Prudential plc. At 31 December 2005, the deficit on the PSPS Scheme was apportioned in the ratio 70/30 between the Company's with-profits fund and Prudential plc. This ratio was determined following extensive analysis of the source of the cumulative funding for the scheme to that date. This basis has been applied for 2006 to the assets and liability movements relating to the start position and also to the deficit funding paid in the year. However, the FRS 17 service cost for the year and employer contributions for ongoing service of current employees have been apportioned in the ratio relevant to current activity.

For SAPS, it is estimated that 50 % of the deficit is attributable to the Company's with-profits fund and the other 50 % is attributable to the Company's shareholders' funds.

Notes on the financial statements (continued)

For both schemes, the projected unit method was used for the most recent full actuarial valuations. Defined benefit schemes are generally required to be subject to full actuarial valuation every three years to assess the appropriate level of funding for schemes having regard to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. PSPS was last actuarially valued as at 5 April 2005 and this valuation demonstrated the Scheme to be 94% funded, with a shortfall of actuarially determined assets to liabilities of 6%, representing a deficit of £243 million.

The finalisation of the valuation as at 5 April 2005 was accompanied by changes to the basis of funding for the scheme. For 2006 and future years deficit funding amounts designed to eliminate the actuarial deficit over a 10-year period have been and are being made. Total contributions to the Scheme for deficit funding and employer's contributions for ongoing service for current employees are expected to be of the order of £70-75 million per annum over a 10-year period. However in 2006 total contributions for the year to 5 April 2006 were £137 million. This amount reflects the increased level of current contributions for ongoing service and deficit funding backdated to 6 April 2005. These amounts compared to total contributions in 2005 of £19 million.

Corporate Governance

The rules of the defined benefit section of PSPS, a final salary scheme, specify that, in exercising its investment powers, the Trustee's objective is to achieve the best overall investment return consistent with the security of the assets of the scheme. In doing this, regard is had to the nature and duration of the scheme's liabilities. The Trustee sets the benchmark for the asset mix, following analysis of the liabilities by the Scheme's Actuary and, having taken advice from the Investment Managers, then selects benchmark indices for each asset type in order to measure investment performance against a benchmark return.

The Trustee reviews strategy, the asset mix benchmark and the Investment Managers' objectives every three years, to coincide with the Actuarial Valuation, or earlier if the Scheme Actuary recommends. Interim reviews are conducted annually based on changing economic circumstances and financial market levels.

The Trustee sets the general investment policy and specifies any restrictions on types of investment and the degrees of divergence permitted from the benchmark, but delegates the responsibility for selection and realisation of specific investments to the Investment Managers. In carrying out this responsibility, the Investment Managers are required by the Pensions Act 1995 to have regard to the need for diversification and suitability of investments. Subject to a number of restrictions contained within the relevant investment management agreements, the Investment Managers are authorised to invest in any class of investment asset. However, the Investment Managers will not invest in any new class of investment asset without prior consultation with the Trustee.

The Trustee consults the Principal Employer, the Company, on these investment principles, but the ultimate responsibility for the investment of the assets of the scheme lies with the Trustee.

The investment policies and strategies for the other defined benefit scheme, SAPS, which is a final salary scheme, follow similar principles, but have different target allocations, reflecting the particular requirements of the schemes.

The key assumptions adopted for the FRS 17 valuations in PSPS and SAPS were:

	2006	2005
	%	%
Price inflation	3.0	2.8
Rate of increase in salaries	5.0	4.8
Rate of increase of pensions in payments:		
PSPS		
Guaranteed - LPI (Max 5%)	3.0	2.8
Guaranteed - LPI (Max 2.5%)	2.5	2.5
Discretionary	2.5	2.5
SAPS	3.0	2.8
Rate used to discount scheme liabilities	5.2	4.8

Notes on the financial statements (continued)

Long-term expected rates of return	2006	2005
	%	%
Equities	7.50	7.10
Bonds	4.90	4.50
Properties	6.80	6.40
Other assets	5.00	4.50
Weighted average long-term expected rate of return	5.90	6.09

The long-term expected rates of return have been determined after applying due consideration to the requirements of paragraph 54 of FRS 17, in particular, taking account of the values of the assets.

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality, which is broadly in line with that adopted for the 92 series of mortality tables prepared by the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries.

The tables used for PSPS at 31 December 2006 were:

Male: 100 per cent PMA92 with CMIR17 improvements to the valuation date and medium cohort improvements in future

Female: 100 per cent PFA92 with CMIR17 improvements to the valuation date and medium cohort improvements in future

The assumed life expectancies on retirement at age 60, based on the mortality table used was:

	Years	
	Male	Female
Retiring today	25.0	28.1
Retiring in 15 years time	26.1	29.1

The mean term of the current PSPS liabilities is around 20 years.

Using external actuarial advice provided by the professionally qualified actuaries, Watson Wyatt Partners, for the valuation of PSPS and internal advice for SAPS, the most recent full valuations have been updated to 31 December 2006 applying the principles prescribed by FRS 17.

The assets and liabilities of PSPS and SAPS were:

	31 Dec 06		31 Dec 05		31 Dec 04	
	£m	%	£m	%	£m	%
Equities	1,553	30	2483	52	2,518	61
Bonds	2,187	43	1596	34	994	24
Properties	621	12	574	12	520	13
Other assets	753	15	78	2	62	2
Total value of assets	5,114	100	4,731	100	4,094	100
Present value of scheme liabilities	5,014		5,180		4,731	
Surplus (Deficit) in the schemes	100		(449)		(637)	
Allocated as follows:						
Attributable to the Company's with-profits fund	73		(300)		(494)	
Attributable to the Company's shareholders' funds	(21)		(35)		(24)	
Attributable to Prudential plc	48		(114)		(119)	
	100		(449)		(637)	

Notes on the financial statements (continued)

After deducting deferred tax, the amounts reflected in the balance sheet of the Company are:

Allocated as:		
Attributable to the Company's with-profits fund	66	(270)
Attributable to the Company's shareholders' funds	(15)	(24)
	51	(294)

The change in the present value of scheme liabilities and the change in the fair value of the scheme assets of PSPS and SAPS are as follows:

	2006 £m	2005 £m
Present value of scheme liabilities at beginning of year	5,180	4,731
Service costs – current	61	57
Service costs – past	-	(115)
Interest cost	246	245
Employee contributions	1	-
Actuarial (gains) losses	(272)	454
Benefit payments	(202)	(192)
Present value of scheme liabilities at end of year	5,014	5,180

	2006 £m	2005 £m
Fair value of scheme assets at beginning of year	4,731	4,094
Expected return on scheme assets	286	271
Employee contributions	1	-
Employer contributions*	148	25
Actuarial gains	150	533
Benefit payments	(202)	(192)
Fair value of scheme assets at end of year	5,114	4,731

* The contributions include deficit funding and ongoing contributions.

Pension charge and actuarial gains (losses) of PSPS and SAPS

	2006 £m	2005 £m
Pension credit (charge)		
Operating charge – current service cost	(61)	(57)
- past service cost	-	115
Finance income (expense):		
Interest on pension scheme liabilities	(246)	(245)
Expected return on pension scheme assets	286	271
	40	26
Total pension (charge) credit	(21)	84
Less: PSPS amount attributable to Prudential plc	13	(29)
	(8)	55
Amount attributable to the Company's with-profits fund	(1)	61
Amount attributable to the Company's shareholders' funds	(7)	(6)
	(8)	55

Notes on the financial statements (continued)

Actuarial gains (losses)	**2006 £m**	2005 £m	2004 £m
Actual less expected return on scheme assets (3%, (11%) of pension scheme assets)	150	533	112
Experience gains (losses) on scheme liabilities (0% (0%) of the present value of scheme liabilities)	18	(1)	(21)
Changes in assumptions underlying the present value of scheme liabilities*	254	(453)	(136)
Total actuarial gains (8% (2%) of the present value of the scheme liabilities)	422	79	(45)
Less: PSPS amounts attributable to the Prudential plc	(118)	(28)	10
Add: Additional gains on change of estimate of allocation of opening 2005 PSPS deficit between the Company's with-profits fund and Prudential plc	-	59	-
	304	110	(35)
Amount attributable to the Company's with-profits fund	288	118	(37)
Amount attributable to the Company's shareholders' funds	16	(8)	2
	304	110	(35)

* In 2006, a £37 million actuarial loss was recognised relating to the measurement of the death in service benefits.

Since the shareholders' profit in respect of the Company's with-profits fund is a function of the actuarially determined surplus for distribution, the overall profit and loss account result is not directly affected by the level of pension cost or other expenses relating to the with-profits fund. The amounts of pension charge of £1 million (2005: credit of £61 million) and actuarial gains of £288 million (2005: £118 million) attributable to the Company's with-profits fund are included in the technical account and reflected in the transfer to or from the fund for future appropriations.

The additional gains of £59 million in 2005 reflects the changed estimate of allocation in the deficit of PSPS from a ratio of 80/20 between the Company's with-profits fund and Prudential plc prior to 2005 to a ratio of 70/30 from 2005 onwards.

The pension charge of £7 million (2005: £6 million) attributable to the Company's shareholders' funds are included in the non-technical account. The actuarial gains before tax attributable to the Company's shareholders' funds of £16 million (2005: losses of £8 million) are recorded in the statement of total recognised gains and losses. Cumulative actuarial gains shown in the statement of total recognised gains and losses as at 31 December 2006 for the Company amounted to £10 million (2005: cumulative actuarial loss of £6 million).

The total actual return on scheme assets for both PSPS and SAPS is £436 million (2005: £804 million) of which £314 million (2005: £578 million) relates to the amounts attributable to the Company's with-profits funds.

Total employer contributions expected to be paid into PSPS and SAPS for the year ending 31 December 2007 amounts to £85 million.

Defined Contribution Pension Schemes

The Company operates defined contribution schemes in Hong Kong. The cost of these contributions was £1.2m (2005: £1.0m). £0.2m was outstanding at 31 December 2006 (2005: £0.1m).

Share-based payments

The Company participates in a number of share award and share option plans relating to Prudential plc shares, which are described below.

Notes on the financial statements (continued)

The Restricted Share Plan (RSP) was, until March 2006 the Company's long-term incentive plan for executive directors and other senior executives designed to provide rewards linked to shareholder return. Each year participants were granted a conditional option to receive a number of shares. There is a deferment period, currently three years, at the end of which the award vests to an extent that depends on the performance of the Group's shares including notional reinvested dividends and on the Group's underlying financial performance. After vesting, the award may then be exercised at zero cost at any time, subject to closed period rules, in the balance of a 10-year period. Shares are purchased in the open market by a trust for the benefit of qualifying employees. Currently, the trust holds at least the maximum number of shares conditionally awarded and not yet forfeited or exercised. The Group Performance Share Plan (GPSP) is the new incentive plan and was established as a replacement for the Restricted Share Plan (RSP) under which no further awards could be made after March 2006. Currently only the directors of the Company, who are also directors of Prudential plc participate in GPSP, and as such their interests are included in the annual report and accounts of Prudential plc and not the Company. The remaining directors of the Company do not participate in GPSP.

The Savings-Related Share Option Scheme is designed to foster share ownership among UK and certain non-UK employees. Permanent employees are eligible for this plan if they have been employed by the Group for the previous six months. At the outset, participants choose an option period (three, five or seven years, or a combination of these periods) and the amount of monthly contributions to be made from their earnings during the option period, which determines the number of options granted. The option price is fixed at the start and is based on a discount of 20 per cent to the market price. Participants may exercise their options within six months of the end of the option period. If options are not exercised, participants are entitled to receive a refund of their cash contributions plus interest.

The Prudential International Savings-Related Share Option Scheme operates on a similar basis to the UK Savings-Related Share Option Scheme for employees in Hong Kong.

No options may be granted under the savings-related schemes described above if such grant would cause the number of shares which have been issued, or which remain issuable pursuant to options granted in the preceding 10 years under the scheme and other share option schemes operated by the Company, or which have been issued under any other share incentive scheme of the Company, to exceed 10 per cent of the Company's issued ordinary share capital at the proposed date of grant.

The Prudential UK Share Incentive Plan (SIP) is also designed to foster share ownership amongst staff. It enables employees to buy shares on a tax efficient basis. For every four partnership shares bought, an additional matching share is granted, purchased on the open market. Participants have voting rights and are entitled to dividends which are reinvested in the SIP. Partnership shares may be withdrawn from the scheme at any time while matching shares may only be withdrawn five years after their award date.

The 1000 Day Long Term Incentive Plan (LTIP) is a UK insurance operations plan in which the UK Remuneration Committee were able to select employees, up to 5 October 2005, at its absolute discretion to participate in the plan. The performance period was 1,000 days and based upon the final performance level being at, or above, the threshold level, the committee shall grant participants 10 per cent of the allocated award in 2005, 20 per cent in 2006 and the remaining 70 per cent in 2007. There are no beneficial interests, or any rights to dividends until such time as the awards are released, at nil cost, to participants.

The other arrangements relate to various awards that have been made without performance conditions to individual employees, typically to ensure their appointment or retention.

Notes on the financial statements (continued)

Movements in share options outstanding under the Company's share-based compensation plans relating to Prudential plc shares during 2006 and 2005 were as follows:

Options outstanding (including conditional options)	**2006** Number of options	**2006** Weighted average exercise price £	2005 Number of options	2005 Weighted average exercise price £
Beginning of year:	**513,288**	**1.83**	550,231	1.58
Granted	**186,069**	**3.73**	68,349	3.94
Exercised	**(129,061)**	**2.83**	(32,255)	3.29
Forfeited	**(116,802)**	**0.71**	(1,132)	3.43
Expired	**(96,388)**	**0.80**	(71,905)	1.23
End of year	**357,106**	**3.10**	513,288	1.83
Options immediately exercisable, end of year	**2,722**	**4.83**	28,455	3.32

The weighted average share price of Prudential plc for the year ended 31 December 2006 was £6.25 compared to £5.01 for the year ended 31 December 2005.

Movements in share awards outstanding under the Group's share-based compensation plans relating to Prudential plc shares at 31 December 2006 and 2005 were as follows:

Awards outstanding	**2006** Number of awards	2005 Number of awards
Beginning of year:	**61,256**	3,536
Granted	**153,321**	71,409
Exercised	**(89,092)**	(13.499)
Forfeited	**(1,468)**	(190)
Expired	**-**	-
End of year	**124,017**	61,256

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2006.

Range of exercise prices	Outstanding Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	Exercisable Number exercisable	Weighted average exercise prices £
Between £0 and £1	98,871	8.27	0.00	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	19,511	1.92	2.66	-	-
Between £3 and £4	92,751	1.96	3.57	1,596	3.62
Between £4 and £5	98,200	3.43	4.62	-	-
Between £5 and £6	46,410	2.91	5.64	-	-
Between £6 and £7	1,363	0.76	6.47	1,126	6.54
Between £7 and £8	-	-	-	-	-
	357,106	4.23	3.10	2,722	4.83

Notes on the financial statements (continued)

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2005.

	Outstanding			Exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise prices	Number exercisable	Weighted average exercise prices
Range of exercise prices		(years)	£		£
Between £0 and £1	225,157	6.52	0.00	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	138,150	1.27	2.66	-	-
Between £3 and £4	120,332	2.50	3.53	28,213	3.29
Between £4 and £5	23,730	3.66	4.07	-	-
Between £5 and £6	4,314	1.41	5.62	-	-
Between £6 and £7	1,605	1.73	6.54	242	6.95
Between £7 and £8	-	-	-	-	-
	513,288	4.01	1.83	28,455	3.32

The weighted average fair values of Prudential plc options and awards granted during the period are as follows:

2006			2005		
Weighted average fair value			Weighted average fair value		
RSP	**Other options**	**Awards**	RSP	Other options	Awards
£	**£**	**£**	£	£	£
4.79	1.96	-	-	1.83	4.83

The fair value amounts relating to RSP options and other options were determined using the Black-Scholes and the Monte Carlo option-pricing models using the following assumptions:

	2006		2005	
	RSP	**Other options**	RSP	Other options
Dividend yield (%)	2.64	2.64	3.19	3.19
Expected volatility (%)	25.48	34.32	42.93	40.38
Risk-free interest rate (%)	4.46	4.69	-	4.48
Expected option life (years)	3.00	3.20	-	3.52
Weighted average exercise price (£)	-	5.11	-	3.94
Weighted average share price (£)	7.16	6.52	5.01	5.11

Compensation costs for all share-based compensation plans are determined using the Black-Scholes model and the Monte Carlo model. Share options and awards are valued using the share price at the date of grant. The compensation costs for all awards and options are recognised in net income over the plans' respective vesting periods. The Black-Scholes model is used to value all options other than RSP. For the RSP the Monte Carlo model is used to allow for the performance conditions. The models are used to calculate fair values at the grant date based on the quoted market price of the stock, the amount, if any that the employees are required to pay, the dividend yield, expected volatility, risk-free interest rates and exercise prices.

The expected volatility is measured as the standard deviation of expected share price returns based on statistical analysis of daily share prices over a period up to the grant date equal to the expected life of options. Risk free interest rates are UK gilt rates with projections for three, five and seven year terms to match corresponding vesting periods. Dividend yield is determined as the average yield over the year of the grant and expected dividends are not incorporated into the measurement of fair value.

Notes on the financial statements (continued)

11. Directors' emoluments

	2006	2005
	£	£
Aggregate emoluments	**2,691,345**	2,685,125
Aggregate amounts receivable (excluding shares) under long term incentive schemes	**74,823**	-
Compensation for loss of office	**240,875**	-
Excess retirement benefits:		
Current directors	**103,640**	28,185
Past directors	**19,345**	51,363
	3,130,028	2,764,673
Highest Paid Director		
Aggregate emoluments and amounts receivable (excluding shares) under long term incentive schemes	**1,027,236**	809,354
Accrued pension at end of the year	**-**	8,066
	1,027,236	817,420

No (2005: Nil) directors exercised share options during the year. Nine (2005: eleven) directors were entitled to shares under Prudential's main long-term incentive scheme and seven directors (2005: nine) were entitled to retirement funds under defined benefit schemes. One (2005: three) director, being subject to the earnings cap, was also entitled to benefits under money purchase schemes pre- A-Day. However, the company did not bear the cost in 2006 and in 2005 bore the cost for two directors which totalled £190,689, of which £164,495 related to the highest paid director. The highest paid director did not exercise any share options but did receive shares under long-term incentive schemes. The highest paid director in 2005 did not exercise any share options but did receive shares under long-term incentive schemes.

12. Auditors' remuneration

During the year the Company obtained the following services from KPMG Audit Plc (KPMG) at costs as detailed below:

	2006 £m	2005 £m
Audit services		
Fees payable to KPMG for the audit of the Company's accounts	**1.1**	1.1
Non-audit services		
Fees payable to KPMG and its associates for other services:		
Other services pursuant to legislation, including the audit of the regulatory return	**1.7**	0.6
	2.8	1.7

13. Intangible assets

	Goodwill £m	Licence £m	Total £m
Balance at beginning of year	63	147	210
Amortised in year			
Charged to non-technical account	(33)	-	(33)
Charged to the long-term business technical account	-	(9)	(9)
Balance at end of year	30	138	168

The goodwill arose on the purchase by the Company of the Scottish Amicable Life Assurance Society on 30 September 1997 and is being amortised from 1 January 1998 over a period of 10 years.
The licence primarily represents the value of an agreement with a fellow subsidiary company for the use of certain Scottish Amicable assets, which is being amortised over a period of 20 years to 30 September 2017, on a basis consistent with the revenue stream from the agreement. Under this basis, the amortisation commenced in the year 2000, when the benefits from the agreement first started to arise. The licence also includes £25m in respect of the estimated net present value of income from current service agreements, which are being amortised from 1 January 1998 over a period of 10 years.

Notes on the financial statements (continued)

14. Land and buildings

	2006 £m	2005 £m
Current value		
Freeholds	**6,816**	7,017
Leaseholds with a term of over 50 years	**3,865**	3,560
Leaseholds with a term of less than 50 years	**266**	271
	10,947	10,848
Cost	**5,609**	5,908

The value of land and buildings occupied by the Company amounted to £142m (2005: £119m)

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	**5,609**	5,908
Aggregate depreciation	**(1,355)**	(1,524)
Net book value based on historical cost	**4,254**	4,384

15. Investments in group undertakings and participating interests

	Cost		**Current value**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Shares in group undertakings				
Long-term fund investments	**1,426**	1,056	**3,293**	2,620
Shareholder investments	**809**	697	**2,259**	1,907
	2,235	1,753	**5,552**	4,527
Loans to group undertakings				
Long-term fund loans	**913**	886	**913**	886
Total	**3,148**	2,639	**6,465**	5,413

The principal subsidiary undertakings of the Company at 31 December 2006, all wholly owned:

		Class of shares held	Principal Activity	Country of Incorporation
	The Prudential Assurance Company Singapore (Pte) Limited	Ordinary shares S$1	Insurance	Singapore
	Prudential Pensions Limited	Ordinary shares £1	Pensions	England and Wales
	Prudential (AN) Limited	Ordinary shares £1	Pensions and pension annuities	England and Wales
	Prudential Holborn Life Limited	Ordinary shares £1	Insurance	England and Wales
	Prudential Retirement Income Limited	Ordinary shares £1	Pension annuities	Scotland
*	Prudential Annuities Limited	Ordinary shares £1	Pension annuities	England and Wales

* Owned by the long-term fund.

Notes on the financial statements (continued)

Shares in group undertakings include Joint Ventures:

	Class and proportion of shares held	Principal Activity	Country of Incorporation
Prudential Health Limited	A ordinary shares £1 50% holding	Private medical insurance	England and Wales

16. Other financial investments

	Cost		Carrying value	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Shares and other variable yield securities and units in unit trusts	**28,792**	29,487	**51,184**	49,685
Debt securities and other fixed income securities	**23,263**	20,747	**23,167**	22,081
Derivative assets	**(270)**	37	**255**	132
Loans secured by mortgages	**21**	21	**21**	27
Loans to policyholders secured by insurance policies	**64**	70	**64**	70
Other loans	**820**	787	**820**	793
Deposits with credit institutions	**5,215**	4,699	**5,215**	4,699
	57,905	55,848	**80,726**	77,487

The change in carrying value of other financial investments included in the Profit and Loss account was a gain of £759m (2005: £7,655m) analysed between a gain of £743m (2005: £7,656m gain) included in the Long-term business technical account and a gain of £16m (2005: £1m loss) included in the Non-technical account. The change in carrying value of £759m (2005: £7,655m) included a gain of £2,059m (2005: £6,815m) in respect of equity securities, a loss of £1,377m (2005: £709m gain) in respect of debt securities and a remaining gain of £77m (2005: £131m) in respect of other financial instruments.

Amounts included in the above relating to listed investments:	**2006 £m**	2005 £m
Shares and other variable yield securities and units in unit trusts	**49,053**	47,564
Debt securities and other fixed income securities	**20,744**	19,380
	69,797	66,944

The table below analyses the derivative positions of the Company.

	2006 £m	
	Fair value assets	**Fair value liabilities**
Derivative financial instruments held to manage interest rate and currency profile:		
Interest rate swaps	20	12
Cross currency swaps	8	-
Currency exchange forward contracts	167	18
Interest rate swaptions	34	-
Bond futures	2	34
Derivative financial instruments held to manage market risk and efficient investment management:		
Equity options		
Equity futures	7	3
Total return swaps	17	129
Total at 31 December 2006	255	196

Notes on the financial statements (continued)

The nature and extent of the derivative financial instruments used by the Company in 2006 are similar to those used in 2005 and their use is discussed in note 32.

17. Assets held to cover linked liabilities

	Cost		Current value	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Assets held to cover linked liabilities	**7,261**	5,938	**7,863**	7,262

18. Reinsurers' share of technical provisions

The reinsurers' share of the long-term business provision relates mainly to cessions to Prudential Annuities Limited and Prudential Retirement Income Limited, subsidiaries of the Company. The reinsurers' share of the technical provisions for linked liabilities relates mainly to cessions to other group companies.

19. Other debtors

	2006 £m	2005 £m
Amounts owed by fellow subsidiaries and holding company	**78**	108
Amounts owed by subsidiary companies	**29**	24
Tax recoverable	**78**	48
Other	**142**	106
	327	286

20. Tangible fixed assets

	Computer Equipment £m	Fixtures & Fittings £m	Total £m
Cost:			
At 1 January 2006	40	73	113
Exchange differences	(1)	(1)	(2)
Additions			
Disposals	(2)	-	(2)
At 31 December 2006	**37**	**72**	**109**
Depreciation:			
At 1 January 2006	38	63	101
Exchange differences	(1)	(1)	(2)
Provided in the year	2	2	4
Disposals	(2)	-	(2)
At 31 December 2006	**37**	**64**	**101**
Net book value at 31 December 2006	**-**	**8**	**8**
Net book value at 31 December 2005	2	10	12

The charge for depreciation for the year ended 31 December 2005 was £5m.

21. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 15, £120,484m (2005: £114,395m) is attributable to the long-term business fund.

Notes on the financial statements (continued)

22. Share capital

The Company's authorised share capital is £1,787,500,000 comprising 1,550,000,000 ordinary shares of 25p each, of which 816,868,254 shares have been issued fully paid; 1,000,000,000 A Preference Shares of £1 each, of which 1,000,000 shares have been issued fully paid; and 1,600,000,000 B Preference Shares of 25p, of which 347,600,000 have been issued fully paid. During the year 42,000,000 Ordinary Shares of 25p each and 74,000,000 B Preference Shares of 25p were issued at par fully paid during the year.

The A Preference Shares issued shall be redeemed by the Company without notice on 8 May 2016. The premium payable on redemption amounts to 28.08p, which is increased by the percentage of the RPI from a date 30 days prior to the first issue of any preference shares to a date 30 days prior to redemption. The A Preference Shares carry the right to receive an index linked cumulative preferential dividend, payable annually. The A Preference Shares carry no voting rights except if a resolution is proposed abrogating, varying or modifying any of the rights or privileges of the holders of the A Preference Shares, but carry preferential rights in priority to other shareholders to payment on a return of capital in the event of the winding up of the Company. The B Preference Shares issued carry the right to receive a non-cumulative preferential Dividend which shall accrue at the rate of two pence per annum. The B Preference Shares may not be redeemed otherwise than at the option of the Company at any time after the fifth anniversary of the date of issue of such B Preference Share. The B Preference Shares carry no voting rights except if a resolution is proposed in relation to (i) the winding up of the Company, a voluntary arrangement with creditors of the Company or proposed receivership, administrative receivership or administration of the Company; or (ii) an alteration of the rights of the B Preference Shares or in relation to any other matter which will have detrimental effect upon the rights of the B Preference Shares.

23. Shareholders' reserves

	Revaluation reserve	Other reserves	Profit and loss account	Total
	£m	£m	£m	£m
Balance at 1 January 2006	1,057	535	924	2,516
Effect of FRS26 on opening balance sheet	-	-	(13)	(13)
Exchange adjustments	-	-	(4)	(4)
Revaluation of subsidiaries	256	-	-	256
Profit for the financial year	-	-	322	322
Dividends	-	-	(248)	(248)
Actuarial gain on the pension scheme net of related tax	-	-	11	11
Balance at 31 December 2006	1,313	535	992	2,840

	2006 £m	2005 £m
Analysis of profit and loss account:		
Distributable retained profit	635	568
Undistributable retained profit	357	356
	992	924

24. Fund for future appropriations

	2006 £m	2005 £m
Prudential Assurance Company with-profits fund (excluding SAIF)	**13,990**	11,817
Scottish Amicable Insurance Fund (SAIF)	**-**	-
	13,990	11,817

25. Claims outstanding

To take account of the extended settlement period, discounting had previously been applied to asbestosis, pollution and health hazard claims of general business operations in run-off reported in the London Market and Marine business funds. The discounting is no longer applied due to the Solvent Scheme of Arrangement mentioned in Note 8 above.

Notes on the financial statements (continued)

26. Other creditors including taxation and social security

	2006 £m	2005 £m
Amounts owed to fellow subsidiaries	**122**	98
Amounts owed to subsidiary companies	**108**	143
Tax	**330**	268
Derivative liability (see note 16)	**196**	264
Other creditors	**857**	611
	1,613	1,384

27. Preference shares

	2006 £m	2005 £m
A preference shares of £1 each	**1**	1

28. Ultimate parent company

The ultimate and immediate parent company is Prudential plc, which is the parent company that prepares group accounts. Copies of these accounts can be obtained from the Company Secretary, Laurence Pountney Hill, London EC4R 0HH.

29. Related party transactions

The Company has taken advantage of the exemption under paragraph 3(c) of Financial Reporting Standard 8 from disclosing transactions with other subsidiary undertakings of the Prudential group.

During 2006, in respect of the Company's joint venture (Prudential Health Limited), a £10m capital injection was made and £2m was recharged by the Company in respect of support services. In December 2006, the Company committed to making an additional consortium relief payment of up to £10.2m to Prudential Health Limited in respect of 2006 and prior year tax losses. This additional consortium relief amount will be repayable to the Company when Prudential Health Limited has sufficient taxable profits to unwind the arrangement.

30. Long-term business provision

The principal valuation methods and bases adopted for the main relevant classes of business which are not reinsured are as follows:

Business in With-Profits Sub-Fund, SAIF and Defined Charge Participating Sub-Fund

The overarching principle in assumption setting is that realistic provisions are established using best estimate assumptions, taking into account the firm's regulatory duty to treat its customers fairly.

Assumptions are required in three areas, namely:

(i) Retrospective assumptions.
(ii) Prospective assumptions, and
(iii) Stochastic modelling assumptions relating to the economic asset model and management actions

Retrospective assumptions

Retrospective assumptions are required for the accumulation of past asset shares up to the valuation date. These assumptions are determined by reference to actual past experience primarily in relation to investment returns, expenses and miscellaneous surplus. The assumptions include past expense write-offs and enhancements to asset shares, and are as used when calculating specimen asset shares for the purpose of bonus setting.

Notes on the financial statements (continued)

The 2006 year end Investment Return for asset shares is:

Return	With-Profits Sub Fund	High Reversionary Bonus fund	SAIF
Gross return	12.41%	n/a	11.82%
Net return	10.94%	8.72%	10.40%

Prospective assumptions

Prospective assumptions are required for the adjustments to asset shares where a prospective calculation gives a higher result and for the stochastic modelling of the cost of guarantees, options and smoothing.

For asset share adjustments, the economic assumptions used represent our best estimate assumptions allowing for prevailing market conditions at the valuation date.

Expense assumptions have been taken as the level of expenses incurred during 2006.

The mortality assumption has been set to the realistic component of the statutory basis. This means that for a given business class, the margin for adverse deviations (MAD) has been removed from the corresponding statutory assumption.

The table below shows the 2006 mortality bases:

Product	Mortality Table (M/F)	Age Rating Years	Multiplier % (M/F)
Prudence Bond	AM92 / AF92	-1/-1	100/ 100
PSA / PIB	AM92 / AF92	-0.5/-0.5	100 / 100
Personal Pensions	AM92 / AF92	-1/-1	100 / 100
Ordinary Branch assurances	AM92 / AF92	-0.5/-0.5	100 / 100
Industrial Branch	PAC 78 WL (Internal Table)	+0 / +0	70/70
With-Profit Deferred Annuities	AM92 / AF92	-1/-1	100 / 100
With-Profit Immediate Annuities	PMA92c2004 / PFA92c2004	0/0	72/71
SAIF Conventional With-Profits	AM92 / AF92	+1 / +1	70/70
SAIF Conventional With-Profits Pensions	AM92 / AF92	+1 / +1	52.5/52.5
SAIF/ex-SAL Accumulating With-Profits Life	AM92 /AF92	+1 / +1	56/56

For persistency, the assumptions are based on those used for European Embedded Value calculations. The persistency assumptions used to value the cost of options and guarantees are reduced by a 10% margin to make an allowance for the impact of policyholders' group actions in extreme market scenarios.

Stochastic asset model economic calibration and management actions

The cost of options, guarantees and smoothing are assessed on a market consistent basis, so that the reserves held are equal to the theoretical cost of hedging the guarantees in the market. In the absence

Notes on the financial statements (continued)

of a deep, liquid market these costs are assessed using a "market consistent" model, with a market consistent calibration.

In order to value the company's guarantees and options, the stochastic asset/liability model projects the with-profits liabilities forward over the next 40 years for 5,000 separate economic scenarios.

The risk free rate was assumed to be the gilt rate plus 10 bp, to reflect the reduction in the yield available on gilts due to their enhanced liquidity.

Separate asset models are used for the risk free rate, UK equities, overseas equities, corporate bonds, property and real interest rates. Where appropriate securities or derivatives are traded, we have demonstrated that the model is able to closely reproduce these prices. Where this is not the case (for example for property and corporate bonds) we have applied expert judgement. We have also allowed for the correlation of investment returns between different asset classes.

The cost of guarantees, options and smoothing is very sensitive to the bonus, market value reduction and investment policies that the company will employ under varying investment conditions. Our stochastic modelling incorporates several management actions to protect the fund in adverse investment scenarios. These management actions are consistent with the PPFM and our obligation to treat customers fairly.

Other non-linked business

Provisions are calculated by the net premium valuation method. Discount rates are derived from the returns available on appropriate investments and, for equity and property assets, are based on expected income and/or earnings with no allowance for potential future capital growth. Allowance is made as follows for the risk that some or all of the anticipated future income will not be received:

(a) For equity and property assets the income is restricted where necessary to ensure that no individual holding had a yield in excess of the annual yield on the Merrill Lynch over 10 years corporate bond index, less a risk margin of 32 basis points.

(b) For fixed interest securities, aggregate bond asset yields have been adjusted to allow for potential defaults within the non-linked and index-linked asset portfolios respectively. The default allowance is determined from data supplied by our investment manager, which itself is based upon research carried out by one of the major rating agencies. This analysis, based on actual default experience over a 35 year period, produces mean default rates according to credit quality and term to redemption.

In the event of default it may be possible to recover some capital, especially if the loan is secured. The allowance for recovery (or partial recovery) of the loan varies according to the level of security and the following recovery rates are assumed:

First Mortgage Debenture/Senior Secured	75%
Senior Unsecured	45%
Subordinated Debt	20%

To calculate the overall default provision, the corporate bond portfolio is broken down according to credit rating and level of security. The default rate for each category is assumed to vary between 100% and 200% of the appropriate mean default rate reduced by the expected recovery plus a further amount for credit risk and prudence.

Regard is also paid to the yield differential between corporate and government bonds, and prevailing economic circumstances. An additional allowance is made for counterparty risks in connection with derivative contracts.

Notes on the financial statements (continued)

The following discount and mortality bases were used:

	Interest Rate %	Actuarial Mortality Table Reference*
UK (excluding Scottish Amicable Insurance Fund)		
Term assurances - life business	3.20	AM/AF92+1
Term assurances – pensions business	4.00	AM/AF92+1
Scottish Amicable Insurance Fund		
Term assurances - life business	3.00	AM/AF92+1
Term assurances – pensions business	3.75	AM/AF92+1

*For assurances, provision for AIDS is made either by increasing the underlying mortality rates or by holding an explicit additional provision. In both cases, the adjustment is one-third of the "R6A" tables.

Linked business

The provision for mortality, morbidity and expenses is calculated using a discounted cashflow method on the following bases:

Discount Rate	4.25% gross with exception of 4.00% gross for SAIF
Fund Growth	5.25% gross
Mortality	AM/AF92+1 plus 1/3 AIDS "R6A" for most contracts
Administration Expenses	£20 to £232 p.a. depending on the product type
Expense Inflation	3.75% p.a.

Comment [PD1]: Europe DCP

Compared with the 2005 valuation the assumptions regarding administration expenses have been revised to allow for actual and forecast costs, and valuation interest rates have been changed reflecting changes in risk free market yields.

Other long-term business provisions

Additional provisions have been established, the most significant being for the potential costs and expenses of compensating the Company's pension policyholders under the FSA review of pension opt-outs and transfer cases, for the potential costs of compensating endowment mortgage policyholders, for the potential cost of meeting annuity rate guarantees at vesting and for additional expenses, not otherwise catered for in the basic net premium valuation, of running off the industrial branch business.

31. Contingencies and Related Obligations

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

Pension Mis-selling Review

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

Provisions in respect of the costs associated with the review have been included in the change in long-term technical provisions in the Company's profit and loss account and the transfer to or from the fund for future appropriations has been determined accordingly. The table below summarises the change in the pension mis-selling provision for the year ended 31 December 2006. The provisions at 31 December 2005 and 31 December 2006 have been calculated in accordance with FRS 27; provisions reported in previous years were calculated in accordance with the November 2003 version of the ABI's Statement of Recommended Practice on Accounting for Insurance Business.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Balance at start of the period	331	487
Effect of FRS 27 on opening balance sheet	-	(109)
Changes to actuarial assumptions and method of calculation	108	(28)
Discount unwind	15	14
Redress to policyholders	(48)	(21)
Payment of administrative costs	(5)	(12)
Balance at end of the period	401	331

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

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

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

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

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

Notes on the financial statements (continued)

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

Mortgage Endowment Products Review

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

The Company is exposed to mortgage endowment products in respect of policies issued by Scottish Amicable Life plc (SAL) and policies issued by Scottish Amicable Life Assurance Society (SALAS) and transferred into the Scottish Amicable Insurance Fund (SAIF). Provisions of £5 million in the non-profit sub-fund and £45 million in SAIF were held at 31 December 2006 to cover potential compensation in respect of mortgage endowment product mis-selling claims. As SAIF is a separate sub-fund of the Company's long-term business fund, this provision has no impact on shareholders.

In addition, the Company's main with-profits fund paid compensation of £11 million in respect of mortgage endowment products mis-selling claims in the year ended 31 December 2006 and held a provision of £60 million at 31 December 2006, in respect of further compensation. This provision has no impact on the Company's profit before tax.

In May 2006 the Company introduced a deadline for both Prudential and Scottish Amicable mortgage endowment complaints. In line with the time limit prescribed by the FSA and the ABI, impacted customers have three years to lodge a mis-selling complaint from the date they receive their first "red" letter indicating that there is a high risk their mortgage endowment may not achieve its projected final value.

Guaranteed Annuities

The Company used to sell guaranteed annuity products in the UK and held a provision of £47 million at 31 December 2006, within the main with-profits fund to honour guarantees on these products. The Company's main exposure to guaranteed annuities in the UK is through the Scottish Amicable Insurance Fund (SAIF) and a provision of £561 million was held in SAIF at 31 December 2006, to honour the guarantees. As SAIF is a separate sub-fund of the Company's long-term business fund, this provision has no impact on shareholders.

Guarantees and Commitments

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

Inherited Estate

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

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

The Company believes that it would be beneficial if there were greater clarity as to the status of the Inherited Estate. As a result the Company has announced that it has begun a process to determine whether it can achieve that clarity through a reattribution of the inherited estate. As part of this process a Policyholder Advocate has been nominated to represent policyholders' interests. This nomination does not mean that a reattribution will occur.

Given the size of the Company's with-profits business any proposal is likely to be time consuming and complex to implement and is likely to involve a payment to policyholders from shareholders funds. If a reattribution is completed the inherited estate will continue to provide working capital for the long-term insurance fund.

Support of Long-term Business Funds by Shareholders' Funds

In 1997, the business of Scottish Amicable Life Assurance Society, a mutual society, was transferred to the Company. In effecting the transfer, a separate sub-fund, the Scottish Amicable Insurance Fund (SAIF), was established within the Company's long-term business fund. This sub-fund contains all the with-profits business and all other pension business that was transferred. No new business has been or will be written in the sub-fund and the sub-fund is managed to ensure that all the invested assets are distributed to SAIF policyholders over the lifetime of the SAIF policies. With the exception of certain amounts in respect of the unitised with-profits life business, all future earnings arising in SAIF are retained for SAIF policyholders. Any excess (deficiency) of revenue over expense within SAIF during a period is offset by a change in the SAIF technical provisions (no FFA is shown for SAIF in 2006 because technical provisions are set at a level at which the realistic working capital is zero). Shareholders have no interest in the profits of SAIF but are entitled to the investment management fees paid on this business. With the exception of certain guaranteed annuity products mentioned earlier in this note, the majority of SAIF with-profits policies do not guarantee minimum rates of return to policyholders.

Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the Company's long-term fund would be liable to cover any such deficiency. Due to the quality and diversity of the assets in SAIF, and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the directors believe that the probability of either the Company's long-term fund or the Company's shareholders' funds having to contribute to SAIF is remote.

Notes on the financial statements (continued)

32. Financial assets and liabilities

A. Financial instruments – 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 or investment contracts with discretionary participation features accounted for under FRS26 and the ABI SORP as described in the Accounting Policies section.

2006	Fair value through profit and loss	Loans and receivables		Total carrying value	Fair value
	£m	£m		£m	£m
Financial Assets					
Deposits with credit institutions	-	5,215		5,215	5,215
Shares and other variable yield securities and units in unit trusts	51,184	-		51,184	51,184
Debt securities and other fixed income securities (note iii)	23,167	-		23,167	23,167
Loans and receivables:					
Loans secured by mortgages	-	21		21	25
Loans to policyholders secured by insurance policies	-	64		64	64
Other loans	-	820		820	1,027
Derivative assets	255	-		255	255
Accrued investment income		611		611	611
Other debtors		249		249	249
	74,606	6,980		81,586	81,797
	Fair value through profit and loss	**Amortised cost**	**ABI SORP/ FRS26**	**Total carrying value**	**Fair value**
	£m	£m	£m	£m	£m
Financial Liabilities					
Amounts owed to credit institutions	-	60	-	60	60
Investment contracts with discretionary participation features (note i)	-	-	34,081	34,081	-
Investment contracts without discretionary participation features (note ii)	4,365	-	-	4,365	4,365
Deposits received from reinsurers	-	18	-	18	18
Creditors arising out of direct insurance operations	-	77	-	77	77
Creditors arising out of reinsurance operations	-	22	-	22	22
Accruals and deferred income	-	147	-	147	147
Other creditors	-	1,087	-	1,087	1,087
Derivative liabilities	196	-	-	196	196
	4,561	1,411	34,081	40,053	5,972

Notes

(i) It is impractical to determine fair value of investment contracts with discretionary participation features due to the lack of a reliable basis to measure such features. The amounts of investment contracts with discretionary participation features are included within the Long-term business provision.

(ii) The amounts of investment contracts without discretionary participation features are included within the Technical provisions for linked liabilities.

(iii) As at 31 December 2006, £490m of convertible bonds were included in debt securities. There were no convertible bonds included in borrowings.

Determination of fair value

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.

Notes on the financial statements (continued)

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 cashflows 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 where applicable. 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 Company would receive or pay in an arm's length transaction. The amount is 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 borrowings is based on quoted market prices, where available.

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

Use of valuation techniques
At 31 December 2006, the Company held investments with a fair value of £1,897m (2005: £1,796m) which were measured in full or in part using valuation techniques. The majority of these assets are debt securities, which are valued internally using standard practices. These practices are based on assessing the 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 £14m.

Interest income and expense
The interest income on financial assets not at fair value through profit and loss was £288m for the year ended 31 December 2006.
The interest expense on financial liabilities not at fair value through profit and loss was £3m for the year ended 31 December 2006.

Notes on the financial statements (continued)

B. Market Risk

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.

2006	**Fair value interest rate risk**	**Cash flow interest rate risk**	**Not directly exposed to interest rate risk**	**Total**
	£m	**£m**	**£m**	**£m**
Financial Assets				
Deposits with credit institutions	4,020	1,195	-	5,215
Debt securities and other fixed income securities	21,299	1,804	64	23,167
Loans and receivables:				
Loans secured by mortgages	20	1	-	21
Loans to policyholders secured by insurance policies	24	40	-	64
Other loans	627	193	-	820
Derivative asset	26	32	197	255
	26,016	3,265	261	29,542
Financial Liabilities				
Amounts owed to credit institutions	48	12	-	60
Investment contracts without discretionary participation features	-	-	4,365	4,365
Derivative liabilities	40	12	144	196
	88	24	4,509	4,621

The following table sets out the Company's commitments to lend funds at a fixed rate:

2006	**Amount £m**	**Weighted average interest rate %**
Term to maturity:		
5 to 10 years	19.0	5.79

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.

2006	**Balance of financial instruments not at fair value through profit and loss £m**	**Range of effective interest rates applicable as at 31 Dec 2006 %**
Financial Assets		
Deposits with credit institutions	5,215	0.0 to 6.2
Loans and receivables:		
Loans secured by mortgages	21	6.1 to 9.3
Loans to policyholders secured by insurance policies	64	4.5 to 11.0
Other loans	820	4.4 to 15.9
	6,120	
Financial Liabilities		
Amounts owed to credit institutions	60	4.0 to 8.1

Notes on the financial statements (continued)

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, excluding investment contracts without discretionary participation features.

2006	**1 year or less**	**After 1 year to 5 years**	**After 5 years to 10 years**	**After 10 years to 15 years**	**After 15 years to 20 years**	**Over 20 years**	**No stated maturity**	**Total carrying value**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Financial Assets								
Deposits with credit institutions	5,215	-	-	-	-	-	-	5,215
Debt securities and other fixed income securities	646	5,607	6,450	2,207	2,612	5,423	222	23,167
Loans and receivables								
Loans secured by mortgages	-	-	-	-	21	-	-	21
Loans to policyholders secured by insurance policies	6	34	-	-	-	-	24	64
Other loans	24	101	570	38	-	60	27	820
Derivative assets	175	37	17	18	-	8	-	255
	6,066	**5,779**	**7,037**	**2,263**	**2,633**	**5,491**	**273**	**29,542**
Financial Liabilities								
Operational borrowings	-	60	-	-	-	-	-	60
Derivative liabilities	74	117	4	1	-	-	-	196
	74	**177**	**4**	**1**	**-**	**-**	**-**	**256**

Durations of long-term business contracts:

With the exception of most unitised with-profit bonds and other whole of life contracts the majority of the contracts of the Company have a contract term. However, in effect, the maturity term of contracts reflects the earlier of death, maturity, or lapsation. In addition, with-profit contracts include projected future bonuses based on current investment values. The actual amounts payable will vary with future investment performance of SAIF and the WPSF. To ascribe particular amounts payable to these contracts in future years does not provide appropriate information. Instead the Company uses cash flow projections of expected benefit payments as part of the determination of the value of in-force benefits when preparing the European Embedded Value basis results for the Prudential Group. The following table shows the maturity profile of the cash flows used for insurance contracts i.e. those containing significant insurance risk, and investment contracts, which do not contain significant insurance risk:

2006	With-profits business			Other		
	Insurance contracts	Investment contracts	Total	Insurance contracts	Investment contracts	Total
	%	%	%	%	%	%
0-5 years	47	23	36	31	36	32
5-10 years	28	22	26	24	23	24
10-15 years	13	17	15	18	15	17
15-20 years	6	15	10	12	13	12
20-25 years	3	13	7	7	6	7
Over 25 years	3	10	6	8	7	8

Notes:

(i) The cash flow projections of expected benefit payments used in the maturity profile table above are from value of in-force business and exclude the value of future new business, including vesting of internal pension contracts.

(ii) Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.

(iii) Investment contracts under Other comprise unit-linked and similar contracts.

(iv) For business with no maturity term included within the contracts, for example with-profits investment bonds such as Prudence Bond, an assumption is made as to likely duration based on prior experience.

Currency Risk

As at 31 December 2006, the Company held 36% and 5% of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency.

Notes on the financial statements (continued)

The financial assets, of which 92% are held by the with-profit fund, allow the fund to obtain exposure to foreign equity markets.

The financial liabilities, of which 89% are held by the with-profit fund, mainly relate to investment contracts with discretionary participation features.

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

C. Derivatives

The Company uses derivatives to facilitate efficient portfolio management or to reduce investment risk. The most widely used derivatives by the Company are exchange traded futures and currency forwards. The Company also uses over-the-counter swaps (including total return swaps), options, swaptions and warrants.

As part of the efficient portfolio management of the PAC with-profits fund, the fund may, from time to time, invest in cash-settled forward contracts over Prudential plc shares, which are accounted for consistently with other derivatives. This is in order to avoid a mismatch of the with-profits investment portfolio with the investment benchmarks set for its equity-based investment funds. The contracts will form part of the long-term investments of the with-profits fund. The contracts are subject to a number of limitations for legal and regulatory reasons.

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual group entities, of which the Company is one, and relevant counterparties in place under each of these market master agreements.

The total fair value balances of derivative assets and derivative liabilities are shown in Note 16. The notional amount of the derivatives were as follows at 31 December 2006:

2006	**Notional amount on which future payments are based**	
	Asset	**Liability**
	£m	**£m**
Cross-currency swaps	30	26
Equity index call options	1,125	-
Swaptions	-	1,125
Futures	2,306	2,463
Forwards	12,614	12,466
Single stock options	-	6
Total return swaps	895	833
Interest rate swaps	1,805	1,805

D. Credit risk

Securities lending and reverse repurchase agreements

The Company has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The agreements require that amounts between 102% and 105% of the fair value of the loaned securities are held as collateral, depending on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Company's balance sheet, rather they are retained within the appropriate investment classification. Collateral, typically consists of cash, debt securities, equity securities and letters of credit. At 31 December 2006, the Company had lent £5,502 million of securities and held collateral under such agreements if £5,754 million.

At 31 December 2006, the Company had entered into reverse repurchase transactions under which it purchased securities and had taken on the obligation to resell the securities for the purchase price, £586 million, together with accrued interest.

Collateral and pledges under derivative transactions

At 31 December 2006, the Company had pledged £89 million for liabilities and held collateral of £6 million in respect of over-the-counter derivative transactions.

Notes on the financial statements (continued)

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	45,774
Rest of Europe	10,449
North America	15,266
Other	10,097
Total	81,586

E. Impairment of financial assets

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

F. 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 exchange traded futures and currency forwards. The Company also uses over-the-counter swaps (including total return swaps), options, swaptions and warrants.

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.

Market risk

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 are equity risk and interest rate risk because most of its assets are investments that are either equity type of investments and subject to equity price risk, or bonds, mortgages or cash deposits, the values of which are subject to interest rate risk. The amount of risk borne by the Company's shareholders depends on the extent to which its customers share the investment risk through the structure of the Company's products.

The split of the Company's investments between equity investments and interest-sensitive instruments depends principally on the type of liabilities supported by those investments and the amount of capital the Company has available. This mix of liabilities allows the Company to invest a substantial portion of its investment funds in equity and real estate investments that the Company believes produce greater returns over the long term. On the other hand the Company has some liabilities that contain guaranteed returns which generally will be supported by fixed income investments.

Credit risk

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 on the financial statements (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 contain discretionary surrender values or surrender charges, reduces the liquidity risk.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

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 judgements 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.

M E Tucker
Chairman
27 March 2007

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

We have audited the financial statements of The Prudential Assurance Company 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, 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 auditors' 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

The directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 56.

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 whether 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 judgements 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; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
27 March 2007