Registered No: 15454

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Annual Report and Accounts for the Year Ended 2007

Final
Dated 27 March 2008

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

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

Secretary

Miss S D Windridge

Auditor

KPMG Audit Plc, London

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007

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 2008.

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. The defined charge participating sub-fund (DCPSF) forms part of the Company's long-term fund and comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into the Company from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and the with-profits annuity business transferred to the Company from the Equitable Life Assurance Society on 31 December 2007. All profits in this fund accrue to policyholders in the DCPSF. 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.

In 2007, the Company continued its strategy of selectively competing in areas of the retirement savings and income markets where it can generate attractive returns. The Company remains focussed on maximising value from the opportunity afforded by the fast-growing need for retirement solutions. With an ageing population and the concentration of UK wealth in the mass affluent and high net worth sectors, the retirement and near-retirement population will represent the fastest growing segments of the market over the next 10 years. Low savings rates and high levels of consumer debt, combined with the shift in responsibility for providing income during retirement from Government and employers towards individuals, have resulted in individuals being inadequately provided for during increasingly long periods of retirement. These consumers have a need for high quality financial advice and service and are increasingly seeking guarantees and longevity protection from their financial products.

The Company has a unique combination of competitive advantages including its significant longevity experience, multi-asset management capabilities, its brand and financial strength. These put it in a strong position to pursue a value driven strategy.

The Company's Retirement Income business aims to continue to drive profitable growth in its annuities business, building on the pipeline of vestings business from maturing policies in its individual and corporate pensions books.

The Company remains a market leader in the with-profits market. These products offer a medium to long-term, medium risk investment with exposure to a diverse range of assets that is particularly important to many customers against the backdrop of market uncertainty.

Capitalising on the need for inflation protection in retirement, the Company remains the market leader in the growing with-profits annuity market with over 75% market share. Early in 2007 the Company made a number of product enhancements including the facility to accept Protected Rights monies, which was a first in the with-profit annuity market.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

The Company continues to be a leader in the UK corporate pensions market. The corporate pensions book is an important source of vestings for the annuity business.

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.

In the fourth quarter the Company launched an income drawdown product. This product helps customers manage their pension through the various stages of retirement, and offers flexibility whilst providing potential for growth through investment.

During 2007, the Company introduced customer-agreed remuneration across some of its product lines. Under this model, financial advisors, agree their remuneration directly with the customer and not with product provider and in doing so make commission structures far more transparent. This is in line with the Company's focus on building strong long-term relationships with advisors as well as offering market-leading retirement solutions.

In a relatively volatile investment market there has been a marked increase in demand for cautious managed solutions providing enhanced returns. In February 2007, the Cautious managed Growth Fund and Managed Defensive Fund were launched. These funds have the potential to offer a better longer-tern return than a bank or building society account and allow the customer to access real returns with lower volatility. These funds are available across the full tax-wrapper suite, including onshore and offshore bonds and individual pensions.

In December, the Company completed the transfer of Equitable Life's portfolio of in-force with-profits annuities. This book covers approximately 62,000 policies (representing approximately 50,000 annuitants) with assets of approximately £1.74bn. This deal grows the Company's with-profits business and creates value for both Equitable policyholders and the Company's shareholders and policyholders.

The Company has a significant strategic relationship with Royal Bank of Scotland. In 2002, The Company 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.

The Company's operations are structured into two primary business units:

- Retail Life & Pensions
- Corporate Solutions

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 agreement announced in 2007 with Capita to outsource a large proportion of its in-force and new business policy administration is another important milestone for the Prudential Group's UK business of which the Company is a part and is an important element in achieving the Prudential Group's UK business total cost savings target. The contract helps deliver the long term cost savings strategy by removing fixed costs from the business and achieving significant operating efficiencies. This provides a significant reduction in long-term expense risk by providing certainty on per-policy costs as the number of policies in the mature life and pensions book decreases over the coming years.

Risks & uncertainties

The Company is a wholly owned subsidiary of 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 managed acceptance of risk. The Group has a Risk Governance 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.

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.

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 higher credit defaults. In addition, falling investment returns could impair the Company's 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. For instance, regulators in jurisdictions in which the Company operates may change the level of capital required to be held by individual businesses. Also these changes could include possible changes in the regulatory framework for pension arrangements and policies, the regulation of selling practices and solvency requirements. In the United Kingdom several proposed and potential regulatory changes could have significant effect on the types of products the Company provides to its customers and intermediaries and how those products are priced, distributed and sold. These include the Financial Services Authority's (FSA's) Treating Customers Fairly initiative, the FSA's review of retail distribution, the proposed regulatory change affecting the pensions market and the implementation of the new European Union (EU) solvency framework for insurers (Solvency II) which should be implemented by member states during 2012.

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 in the majority of its chosen markets, circumstances could arise where the Company, along with other companies, may be required to make additional material contributions.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

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, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices, including in the latter case businesses it has closed.

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 insurance 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, the Company outsources several operations, including a significant part of its back office and customer-facing functions as well as a number of IT functions. In turn, the Company is reliant upon the operational processing performance 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 as any weakness in the administration systems, finance systems and processes or actuarial provision process could have an impact on its results during the effective period.

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.

In common with other industry participants, the profitability of the Company's businesses ultimately 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 10 to 12, show a profit on ordinary activities before tax of £1,308m (2006: £424m). The results for the year have been dominated by the profit of £941m made on the transfer of Prudential Assurance Company Singapore (Pte) Limited to a fellow company within the Prudential Group, Prudential Singapore Holdings Pte Limited. In addition the results of the with-profits business have increased by 7% from £380m to £407m reflecting strong investment performance and its impact on terminal bonuses. However, the positive with-profits result has been more than offset by disappointing results from the Company's non-profit business.

The shareholders' funds of the Company total £3,292m (2006: £3,131m).

Sales on an APE basis (Regular Premiums plus 1/10th Single Premiums) are up from £783m in 2006 to £929m in 2007 driven principally by the transfer of Equitable Life's portfolio of in-force with-profits annuities which contributed £170m APE. Excluding this transfer and after taking account of the non-renewal of a single contract for credit life sales for which £63m APE was included in the 2006 comparator, the increase in APE in 2007 is 4%. There have also been strong performances in Retail sales of with-profits bonds, individual annuities and corporate pensions. Retail with-profits business performed very strongly across a range of products, including PruFund. The Company's with-profits products offer a medium to long-term, medium risk investment with exposure to a diverse range of assets that is particularly important to many customers against the backdrop of market uncertainty. Growth in individual annuities sales are driven by the continued strength of the internal vesting pipeline together with the growth in the with-profits annuity market that capitalises on the need for inflation protection through an increased retirement period. An income drawdown product was also launched adding to the Company's range of retirement solutions and providing customers with additional options to manage their retirement income. Growth in corporate pension sales is due to a combination of new schemes, increasing scheme membership and incremental contributions to existing schemes.

The Company'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 £8.7bn at 31 December 2007, before a deduction for the risk capital margin. The financial strength of the Company is rated AA+ (stable outlook) by Standard & Poor's, Aa1 (negative outlook) by Moody's and AA+ (stable outlook) by Fitch Ratings as at 31 December 2007.

The with-profits sub-fund delivered a pre-tax investment return of 7.2 per cent in 2007, and over the last five years the fund has achieved a total return of 91 per cent. 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's long-term fund reduced its exposure to property and increased the quality of its corporate bond portfolio. The fund includes the assets of the Equitable Life with-profit annuity business, transferred during the year, which were almost entirely fixed interest corporate bonds.

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

	2007	**2006**	**2005**
	per cent	**per cent**	**per cent**
UK equities	35	36	40
International equities	17	17	19
Property	14	15	15
Bonds	27	26	21
Cash and other assets classes	7	6	5
Total	**100**	**100**	**100**

The Company does not report against Key Performance Indicators in its Business Review. This is because the Company is part of the wider Prudential Group and the Group's business is managed on a divisional basis such as UK Insurance Operations. Key Performance Indicators exist for the management of the divisions, of which this Company's business forms a part. The divisional Key Performance Indicators can be found in the Annual Report of Prudential plc.

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. The Company remains committed to providing a high level of customer service, communicating openly with customers, providing clear information and to monitoring levels of satisfaction.

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.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

Subsidiary undertakings and branches

Particulars of the Company's principal subsidiary undertakings at 31 December 2007 are shown on page 36 in note 15. At 31 December 2007 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 2007 is shown in the balance sheet on pages 14 and 15. The profit and loss account appears on pages 10 to 12.

Share Capital

Changes in the Company's share capital during 2007 are shown on page 38 in note 22.

Dividends

An interim dividend of £288m (2006: £248m) on the ordinary shares was paid on 8 May 2007. The directors have not declared a final dividend on the ordinary shares for 2007 (2006: £Nil).

A dividend on the A preference shares of £30,366.44 was paid on 8 May 2007 (2006: £26,994). 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 (2006: 22 days).

Directors

The present directors are shown on page 1.

Mr A M Crossley was appointed a director of the Company on 13 March 2007. Mrs R Harris resigned as a director on 2 February 2007. There were no other changes during the year.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

Political and Charitable Donations

During 2007 £193,496 was donated to the Przezornosc Foundation (2006: £214,512). This is broken down as follows: Education £141,268; Social and Welfare £31,338; Cultural £10,445; Historical £10,445.

During 2007 the Hong Kong branch made donations of £35,831 (2006: £50,025) as follows: £32,117 was donated to English Adventure, Hong Kong Blood Cancer Fund £2,433 and Hong Kong Children's Cancer Foundation £1,281. This is broken down as follows: Education £32,117; Social and Welfare £3,714.

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. This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

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 (E) on pages 55 to 56.

Further information on the use of derivatives by the Company is provided in note 32 (C) on pages 53 to 54.

Auditor

The members of the Company appointed KPMG Plc as auditor of the Company by ordinary resolution on 8 May 2007. In accordance with Section 487(2) of the Companies Act 2006, KPMG Audit Plc will be deemed to be re-appointed auditor of the Company for the current financial year.

Directors' and officers' protection

Prudential plc has arranged appropriate insurance cover in respect of legal action against directors and senior managers of companies within the Prudential Group. In addition, the Articles of Association of the Company provide that every Director, Manager, Secretary and other officer or servant of the Company shall be indemnified by the Company against, and it shall be the duty of the Directors out of the funds of the Company to pay to him, all costs, losses and expenses which he may incur or become liable to by reason of any contract entered into or any act or deed done by him as such officer or servant or in any way in the discharge of his duties. Prudential plc also provides protections for directors and senior managers of companies within the Group against personal financial exposure they may incur in their capacity as such. These include qualifying third party indemnity provisions (as defined by the relevant Companies Act) for the benefit of directors of Prudential plc including, where applicable, in their capacity as a director of the Company (being Messrs Tucker, Broadley and Prettejohn) and other companies within the Group. These indemnities were in force during 2007 and remain in force.

On behalf of the Board of directors.

S D Windridge
Secretary
27 March 2008

Profit and Loss Account for the year ended 31 December 2007

Note	General Business Technical Account	2007 £m	2006 £m
1b	Gross premiums written		
	Continuing operations	**23**	24
	Outward reinsurance premiums	**(4)**	(5)
	Premiums written, net of reinsurance	**19**	19
	Change in the provision for unearned premiums		
	Gross amount	**(1)**	(1)
	Earned premiums, net of reinsurance	**18**	18
	Claims paid		
	Gross amount	**(18)**	(25)
	Reinsurers' share	**8**	10
	Claims paid, net of reinsurance	**(10)**	(15)
	Change in provision for claims		
	Gross amount	**8**	17
	Reinsurers' share	**(9)**	(7)
	Net of reinsurance	**(1)**	10
	Claims incurred, net of reinsurance	**(11)**	(5)
4	Net operating expenses	**(10)**	(12)
7	Change in the equalisation provision	**-**	3
1b	**Balance on the general business technical account**	**(3)**	4
	Analysis:		
	Continuing operations	**2**	2
8	Operations in run-off	**(5)**	2
		(3)	4

Profit and Loss Account for the year ended 31 December 2007 (continued)

Note	**Long-term Business Technical Account**	**2007 £m**	2006 £m
1a	Gross premiums written	**7,343**	5,814
	Outward reinsurance premiums	**(1,215)**	(1,689)
	Earned premiums, net of reinsurance	**6,128**	4,125
2	Investment income	**8,885**	9,633
	Unrealised (losses) gains on investments	**(1,489)**	1,819
	Claims paid		
	Gross amount	**(9,598)**	(9,547)
	Reinsurers' share	**993**	903
	Claims paid, net of reinsurance	**(8,605)**	(8,644)
	Change in provision for claims		
	Gross amount	**117**	(17)
	Reinsurers' share	**-**	2
	Claims incurred, net of reinsurance	**(8,488)**	(8,659)
	Change in long-term business provision		
	Gross amount	**(3,599)**	(3,101)
	Reinsurers' share	**28**	975
		(3,571)	(2,126)
	Change in technical provision for linked liabilities	**(225)**	(495)
	Change in other technical provisions, net of reinsurance	**(3,796)**	(2,621)
4	Net operating expenses	**(402)**	(910)
5	Investment expenses and charges	**(320)**	(336)
6	Tax attributable to the long-term business	**(47)**	(666)
	Actuarial gain on pension schemes	**205**	288
	Transfer to the fund for future appropriations	**(435)**	(2,370)
	Balance on the long-term business technical account	**241**	303

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 2007 (continued)

Note	**Non-Technical Account**	**2007 £m**	2006 £m
	Balance on the general business technical account	**(3)**	4
	Balance on the long-term business technical account	**241**	303
6	Tax credit attributable to the balance on the long-term business technical account	**89**	101
1a	Balance on the long-term business technical account before tax	**330**	404
2	Investment income	**64**	27
	Unrealised profit on portfolio investments	**33**	17
	Other income	**16**	29
13	Amortisation of goodwill	**(34)**	(33)
	Other charges	**(39)**	(24)
1c	Total profit on other activities	**40**	16
9	Profit on disposal of related undertakings	**941**	-
	Profit on ordinary activities before tax	**1,308**	424
6	Tax on profit on ordinary activities	**(99)**	(102)
	Profit for the financial year	**1,209**	322

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 2007

Note		2007 £m	2006 £m
	Profit for the financial year	**1,209**	322
	Other recognised gains and losses:		
23	(Decrease) increase in surplus on revaluation of investments in shareholder subsidiaries	**(795)**	256
	Exchange adjustments	**-**	(4)
	Actuarial (loss) gain on pension scheme, net of related deferred tax	**(4)**	11
	Total recognised gains relating to the financial year	**410**	585

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2007

	2007 £m	2006 £m
Total recognised gains relating to the financial year	**410**	585
Dividends	**(288)**	(248)
Increase in share capital	**39**	29
Net movement in shareholders' funds	**161**	366
Shareholders' funds at beginning of year	**3,131**	2,765
Shareholders' funds at end of year	**3,292**	3,131
Included in Shareholders' funds are aggregate net foreign exchange differences as follows:		
Aggregate net foreign exchange differences included in opening Shareholders' funds	**-**	(2)
Net foreign exchange differences for the year	**-**	(2)
Aggregate net foreign exchange differences included in closing Shareholders' funds	**-**	(4)

Balance sheet as at 31 December 2007

Note	Assets	2007 £m	2006 £m
13	Intangible assets		
	Licence	**123**	138
	Goodwill	**-**	30
		123	168
	Investments		
14	Land and buildings	**9,587**	10,947
15	Investments in group undertakings and participating interests	**6,364**	6,465
16	Other financial investments	**85,303**	80,726
		101,254	98,138
17	Assets held to cover linked liabilities	**7,899**	7,863
18	Reinsurers' share of technical provisions		
	Provision for unearned premiums	**2**	2
	Long-term business provision	**10,878**	10,851
	Claims outstanding	**29**	38
	Technical provisions for linked liabilities	**4,430**	3,819
		15,339	14,710
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	**68**	82
	Intermediaries	**6**	7
	Debtors arising out of reinsurance operations	**12**	11
19	Other debtors	**1,444**	327
		1,530	427
	Other assets		
20	Tangible assets	**8**	8
25	Cash at bank and in hand	**648**	937
		656	945
	Prepayments and accrued income		
	Accrued interest and rent	**463**	420
	Deferred acquisition costs		
	General business	**4**	4
	Long-term business	**158**	167
	Accrued external dividends receivable	**114**	110
	Other prepayments and accrued income	**66**	81
		805	782
	Total assets (excluding pension asset)	**127,606**	123,033
10	Pension asset (net of related deferred tax)	**284**	51
21	**Total assets (including pension asset)**	**127,890**	123,084

Balance sheet as at 31 December 2007 (continued)

Note	Liabilities	2007 £m	2006 £m
	Capital and reserves		
22	Share capital	**330**	291
23	Revaluation reserve	**518**	1,313
23	Other reserves	**535**	535
23	Profit and loss account	**1,909**	992
1c	Shareholders' funds - equity interests	**3,292**	3,131
24	Fund for future appropriations	**14,410**	13,990
	Technical provisions		
	Provision for unearned premiums	**12**	11
30	Long-term business provision	**93,312**	89,671
	Claims outstanding	**451**	576
7	Equalisation provision	**1**	1
	Unearned revenue provision	**53**	57
	Total technical provisions	**93,829**	90,316
	Technical provisions for linked liabilities	**12,329**	11,682
	Deposits received from reinsurers	**-**	18
	Provisions for other risks and charges		
6	Deferred taxation	**1,754**	2,019
	Other	**-**	8
		1,754	2,027
	Creditors		
	Creditors arising out of direct insurance operations	**53**	77
	Creditors arising out of reinsurance operations	**61**	22
	Amounts owed to credit institutions	**63**	60
26	Other creditors including taxation and social security	**1,956**	1,613
27	Preference shares	**1**	1
		2,134	1,773
	Accruals and deferred income	**142**	147
	Total liabilities	**127,890**	123,084

The accounts on pages 10 to 59 were approved by the Board of directors on 27 March 2008.

M E Tucker
Chairman

Accounting Policies

A. Change in accounting policies

The Company has implemented the following accounting standard and amendment in preparing its results for the year ended 31 December 2007. These standards closely reflect the requirements of International Financial Reporting Standards (IFRS) and form part of the continuing implementation of IFRS in the UK.

FRS 29 "Financial instruments: disclosures"

FRS 29 "Financial instruments: disclosures" implements IFRS 7 "Financial instruments: disclosures" into UK GAAP and replaces the disclosure requirements of FRS 25, "Financial Instruments: Disclosure and Presentation". The latter, therefore, becomes a standard dealing wholly with presentation of financial instruments. FRS 29 is intended to complement the principles for recognising, measuring and presenting financial assets and financial liabilities in FRS 25 and FRS 26, 'Financial Instruments: Recognition and Measurement'. The objective of FRS 29 is to require entities to provide disclosures in their financial statements to enable the users of financial statements to evaluate the significance of financial instruments for the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. Additionally, under FRS 29, the Company is also required to explain its objectives, policies and processes for managing capital.

The additional disclosures required are shown in Note 32 and Note 33. The adoption of this standard represents a change in accounting policy and comparatives have been provided accordingly in the disclosures. There has been no impact on the balance sheet or profit and loss of the Company.

Amendment to FRS 26 "Financial Instruments: Recognition and measurement"

An amendment to FRS 26 "Financial Instruments: Recognition and measurement" was issued in April 2006 which brings the recognition and derecognition requirements of IAS 39 "Financial Instruments: Recognition and measurement" into FRS 26. The amendment applies only to financial assets and liabilities, the relevant requirements of FRS 5 "Reporting the Substance of Transactions" continue to apply to the recognition and derecognition of non-financial assets. The adoption of this amendment to FRS 26 did not have an impact on the balance sheet or profit and loss account of the Company.

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

Following the adoption of FRS 26 in 2006, 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. A further distinction is made between investment contracts with and without discretionary participation features. Discretionary participation features represent the contractual right to receive additional profit-sharing 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 or annuity policies. The investment contract without discretionary participation features classification applies primarily to certain unit-linked and similar contracts written by the Company. Insurance contracts and investment contracts with discretionary participation features are accounted for under previously applied UK GAAP, as

Accounting Policies (continued)

set out in the ABI SORP. Investment contracts without discretionary participation features are accounted for as financial liabilities under FRS 26 and, where relevant the provisions of the ABI SORP in respect of the attaching investment management features of the contracts. FRS 26 applies a different accounting treatment to these contracts than the previously applied UK GAAP primarily in respect of deferred acquisition costs, deferred income reserves and provisions for future expenses commonly called “sterling reserves” (see below).

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.

Technical account treatment

Premiums and annuity considerations for conventional with-profit policies and other protection type life insurance and annuity 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.

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

Following the adoption of FRS26 in 2006, the accounting treatment for investment contracts without discretionary participation features reflects the deposit nature of the arrangement with premiums and claims reflected as deposits and withdrawals taken directly to the balance sheet as a movement on the investors’ liability with the long-term technical account reflecting fee income, expense and taxation on these contracts.

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

Following the adoption of FRS26 in 2006, for the investment contracts without discretionary participation features, only the incremental, directly attributable acquisition costs relating to the securing of investment management element of the contracts can be capitalised and amortised in line with related revenue. If these contracts involve up-front charges, this income is also deferred and amortised through the technical account in line with contractual service provision.

Sterling reserves are not permitted to be recognised under FRS26 for investment contracts.

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.

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

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.

Accounting Policies (continued)

Realistic reserves are established using best estimate assumptions, and taking into account the firm's regulatory duty to treat its customers fairly.

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, shareholders' transfers are recognised only on declaration, consistent with the current basis of financial reporting.

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.

Under FSA reporting, the assets include the present value of future profits of PAL and of non-profit business written within the with-profit funds. Under FRS 27 these items are not recognised. Similarly, that part of these future profits which is included in the FSA FPRL is excluded 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.

Accounting Policies (continued)

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

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 and expanded by the Additional Guidance on European Embedded Value Disclosures issued in October 2005. 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.

Following the adoption of FRS26 in 2006, upon initial recognition financial investments are recognised 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.

(ii) The Company uses bid prices to value its quoted financial 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.

(iii) 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 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.

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. The UKGAAP rules for taxing long-term business are significantly different to those applying to non-insurance companies and the different classes of business written by the Company are themselves subject to distinct rules. Furthermore the tax calculations are performed using data from the regulatory returns submitted to the FSA rather than the accounts results. There may be significant and complex differences between the regulatory and accounting bases.

Accounting Policies (continued)

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. Monetary 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.

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 87% 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**	
	2007 £m	2006 £m	**2007 £m**	2006 £m
United Kingdom	**6,032**	4,776	**292**	368
Hong Kong	**1,003**	807	**37**	36
France	**308**	231	**1**	-
	7,343	5,814	**330**	404

New business	**Regular premiums**		**Single premiums**	
	2007 £m	2006 £m	**2007 £m**	2006 £m
United Kingdom	**222**	219	**5,081**	3,851
Hong Kong	**118**	94	**502**	355
France	**-**	26	**308**	231
	340	339	**5,891**	4,437

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 2007 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	**2007 £m**	2006 £m
Gross written premiums:-		
Direct	**7,037**	5,584
Reinsurance accepted	**306**	230
	7,343	5,814
Analysis of gross direct premiums:-		
Individual business	**6,030**	4,621
Group contracts	**1,007**	963
	7,037	5,584
Regular premiums	**2,032**	2,095
Single premiums	**5,005**	3,489
	7,037	5,584
Participating contracts	**5,867**	3,843
Non-participating contracts	**588**	1,300
Linked long-term contracts (excluding investment contracts without discretionary participation features for 2007 and 2006)	**582**	441
	7,037	5,584
United Kingdom	**6,032**	4,776
Hong Kong	**1,003**	807
France	**2**	1
	7,037	5,584

Net reinsurance income

Net reinsurance income in respect of long-term business for the year ended 31 December 2007 was £417m (2006: £477m).

Notes on the financial statements (continued)

1. Segmental analysis (continued)

(b) General business

Premiums and underwriting result		Gross premiums written		Underwriting result	
		2007 £m	2006 £m	**2007 £m**	2006 £m
Continuing operations	Hong Kong	**23**	24	**2**	2
Operations in run-off	United Kingdom	**-**	-	**(5)**	2
		23	24	**(3)**	4

Analysis of technical account	Gross Premiums Written		Gross Premiums Earned		Gross Claims Incurred		Gross Operating Expenses		Reinsurance Balance	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Motor -other classes	**1**	1	**1**	1	**-**	2	**1**	1	**-**	2
Marine, aviation and transport	**-**	-	**-**	-	**-**	2	**-**	2	**-**	-
Fire and other damage	**3**	4	**3**	3	**(1)**	2	**1**	-	**(2)**	2
Other	**19**	19	**18**	19	**11**	2	**8**	9	**(3)**	(3)
	23	24	**22**	23	**10**	8	**10**	12	**(5)**	1

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	
	2007 £m	2006 £m	**2007 £m**	2006 £m
United Kingdom	**2**	(10)	**3,094**	1,959
Singapore	**-**	12	**-**	964
Taiwan	**2**	-	**13**	67
Other countries	**36**	14	**185**	141
	40	16	**3,292**	3,131

Notes on the financial statements (continued)

2. Investment income

	Long- term business		Non-technical account	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Income from:				
Group undertakings	**130**	57	**61**	36
Other investments				
Land and buildings	**589**	658	**-**	-
Listed investments	**3,008**	3,067	**4**	4
Unlisted investments	**252**	130	**-**	-
Other investments	**398**	411	**-**	(7)
	4,377	4,323	**65**	33
Gains (losses) on loans and receivables	**43**	(6)	**-**	-
Gains (losses) on the realisation of investments at fair value through profit and loss other than derivatives	**4,355**	4,423	**(1)**	(6)
Gains on the realisation of derivatives	**38**	1,027	**-**	-
Exchange gains (losses)	**40**	(168)	**-**	-
Fees for policy administration and asset management services arising from unit-linked investment contracts	**32**	34	**-**	-
	8,885	9,633	**64**	27

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 £3,357m (2006: £3,072m).

4. Net operating expenses

	Long-term business		General business	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Depreciation	**2**	4	**-**	-
Acquisition costs	**159**	562	**7**	7
Change in deferred acquisition costs	**9**	29	**-**	-
Administrative expenses	**221**	306	**3**	5
Amortisation of licence (Note 13)	**11**	9	**-**	-
	402	910	**10**	12

Acquisition costs include commissions in respect of long-term direct insurance business of £18m (2006: £412m) and general direct insurance business of £6m (2006: £6m).

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

5. Investment expenses and charges

	Long-term business		Non-technical account	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Investment management expenses	**283**	297	**-**	-
Interest on bank borrowings	**37**	39	**-**	-
	320	336	**-**	-

Notes on the financial statements (continued)

6. Tax

a) Tax charged/(credited)	**Long-term funds**		**Shareholders' Profits**	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Current Tax				
UK corporation tax	**484**	466	**18**	21
Double tax relief	**(31)**	(35)	**(13)**	(11)
Overseas tax	**67**	59	**4**	2
Adjustments in respect of prior year	**(230)**	4	**(3)**	(13)
Total current tax	**290**	494	**6**	(1)
Deferred tax				
Origination and reversal of timing differences	**(230)**	162	**5**	-
Adjustments in respect of prior year	**(13)**	10	**(1)**	2
Total deferred tax	**(243)**	172	**4**	2
Shareholders' attributable tax				
Current			**68**	76
Deferred			**21**	25
Total shareholders' attributable tax			**89**	101
Tax charge on profit on ordinary activities	**47**	666	**99**	102

b) Factors affecting tax charge for the period

	2007 £m	2006 £m
Profit on ordinary activities before tax	**1,308**	424
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30 per cent (2006: 30 per cent)	**392**	127
Permanent differences	**(2)**	(3)
Adjustment to current tax in respect of previous periods	**(26)**	(13)
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)	**3**	(13)
Effect of short term timing differences	**-**	(26)
Effect of double taxation relief	**(12)**	(6)
Franked investment income	**(2)**	(3)
Tax taken to reserves	**-**	(1)
Extra group relief on Prudential Health Limited losses	**-**	5
Non-taxable profit on transfer of subsidiary	**(289)**	-
Current tax charge for the period	**74**	75

Notes on the financial statements (continued)

c) Balance Sheet

	Attributable to Long-term funds		Attributable to Shareholders' funds	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Provision for Deferred Tax				
Accelerated capital allowances	**1**	5	**-**	(1)
Policy reserves	**56**	61	**-**	-
Short term timing differences	**(52)**	(32)	**(6)**	(7)
Unrealised gains	**1,866**	2,140	**-**	-
Deferred acquisition costs	**(111)**	(147)	**-**	-
Undiscounted provision for deferred tax liability/(deferred tax asset)	**1,760**	2,027	**(6)**	(8)
Deferred tax liability at start of the period	**2,027**	1,892	**(8)**	(12)
Effect of FRS26 on opening balance sheet	**-**	2	**-**	-
Deferred tax (credited) charged in technical/ non-technical account for the period	**(267)**	133	**2**	4
Deferred tax liability/(deferred tax asset) at end of the period	**1,760**	2,027	**(6)**	(8)

In April 2008 the standard corporation tax rate for the UK will change from 30% to 28%. Deferred tax at the end of 2007 for UK operations has been provided at the new rate of 28% on the basis that materially all of the temporary differences are expected to reverse once the new rate has taken effect. The effect of this change on the deferred tax assets and liabilities at 31 December 2007 was £8 million.

The deferred tax liability relating to the Pension Asset attributable to the Company of £27m (2006: £1m) 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 (2006: £1m). There has been no movement in the equalisation provision during the year (2006: £3m). 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:

	2007 £m	2006 £m
Claims incurred, net of reinsurance		
Claims paid	**(2)**	(7)
Change in provision for claims	**(1)**	11
Total	**(3)**	4
Net operating expenses	**(2)**	(4)
Change in the equalisation provision	**-**	2
Technical result	**(5)**	2
Investment return	**5**	-
Operating profit before tax	**-**	2

Notes on the financial statements (continued)

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.

9. Acquisition and disposal of subsidiaries and participating interests

On 20 September 2007 the Company transferred Prudential Assurance Company Singapore (Pte) Limited to Prudential Singapore Holdings Pte Limited for £949m. After taking into account the cost of £8m the profit on disposal was £941m.

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.

10. Information on staff and pension costs

The average number of persons employed by the Company During the year was:	**2007**	2006
United Kingdom	**82**	109
Hong Kong	**711**	678
	793	787

The costs of employment were:	**2007 £m**	2006 £m
Wages and salaries	**27**	24
Other pension costs in respect of defined contribution schemes (see below)	**1**	1
	28	25

Defined Benefit Pension Schemes

With the exception of employees of consolidated venture fund investment subsidiaries, the majority of staff employed by the Prudential Group in the UK 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 2007, on the FRS 17 "Retirement Benefits" (FRS 17) basis of valuation, PSPS accounts for 87% (2006: 88%) 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. In 2006, the Company adopted the Amendment to FRS 17 issued in December 2006 in the Company's financial statements which aligned the FRS 17 disclosures with IAS 19.

Surpluses and deficits on the Prudential Group's defined benefit schemes are apportioned between Prudential plc and the Company's shareholders' funds and with-profits sub-funds based on estimates of employees' service between them. At 31 December 2005, the deficit of PSPS was apportioned in the ratio 70/30 between the Company's with-profits sub-fund and Prudential plc following detailed consideration of the sourcing of previous contributions. This ratio was applied to the base deficit position at 1 January 2006 and for the purpose of determining the allocation of the movements in that position up to 31 December 2007. The FRS 17 service charge and ongoing

Notes on the financial statements (continued)

employer contributions are allocated by reference to the cost allocation for current activity.

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

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 £243m.

The valuation as at 5 April 2005 was accompanied by changes to the basis of funding for the scheme with effect from that date. Deficit funding amounts designed to eliminate the actuarial deficit over a 10-year period have been and are being made. Based on that valuation 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 £70-75m per annum over a 10-year period. In 2007 total contributions for the year including expenses and augmentation were £82m (2006: £137m). The 2006 amount reflected the increased level of contributions for ongoing service and deficit funding backdated to 6 April 2005.

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.

Notes on the financial statements (continued)

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

	2007	2006
	%	%
Price inflation	3.3	3.0
Rate of increase in salaries	5.3	5.0
Rate of increase of pensions in payments:		
PSPS		
Guaranteed - LPI (Max 5%)	3.3	3.0
Guaranteed - LPI (Max 2.5%)	2.5	2.5
Discretionary	2.5	2.5
SAPS	3.3	3.0
Rate used to discount scheme liabilities	5.9	5.2

Long-term expected rates of return	Prospectively for 2008	2007	2006
	%	%	%
Equities	7.50	7.50	7.10
Bonds	5.40	4.90	4.50
Properties	6.75	6.80	6.40
Other assets	5.50	5.00	4.50
Weighted average long-term expected rate of return	6.10	5.90	6.10

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. In 2007 the mortality assumptions were strengthened by including a floor to the medium cohort improvements.

The tables used for PSPS at 31 December 2007 were:

Male: 100 per cent PMA92 with CMIR17 improvements to the valuation date and medium cohort improvements subject to a floor of 1.75% up to the age of 90, decreasing linearly to zero by the age of 120.

Female: 100 per cent PFA92 with CMIR17 improvements to the valuation date and 75% medium cohort improvements subject to a floor of 1.0% up to the age of 90, decreasing linearly to zero by the age of 120.

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

	2007 Years		2006 Years	
	Male	Female	Male	Female
Retiring today	26.2	28.3	25.0	28.1
Retiring in 15 years time	28.7	29.3	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 2007 applying the principles prescribed by FRS 17.

Notes on the financial statements (continued)

The assets and liabilities of PSPS and SAPS were:

	31 Dec 07		31 Dec 06		31 Dec 05	
	£m	%	£m	%	£m	%
Equities	1,472	28	1,553	30	2,483	52
Bonds	1,299	25	2,187	43	1,596	34
Properties	583	11	621	12	574	12
Other assets	1,935	36	753	15	78	2
Total value of assets	5,289	100	5,114	100	4,731	100
Present value of scheme liabilities	4,815		5,014		5,180	
Surplus (Deficit) in the schemes	474		100		(449)	
Allocated as follows:						
Attributable to the Company’s with-profits fund	338		73		(300)	
Attributable to the Company’s shareholders’ funds	(27)		(21)		(35)	
Attributable to Prudential plc	163		48		(114)	
	474		100		(449)	

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

	2007 £m	2006 £m	2005 £m
Allocated as:			
Attributable to the Company's with-profits fund	304	66	(270)
Attributable to the Company's shareholders' funds	(20)	(15)	(24)
	284	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:

	2007 £m	2006 £m
Present value of scheme liabilities at beginning of year	5,014	5,180
Service costs – current	52	61
Interest cost	255	246
Employee contributions	2	1
Actuarial gains	(293)	(272)
Benefit payments	(215)	(202)
Present value of scheme liabilities at end of year	4,815	5,014

	2007 £m	2006 £m
Fair value of scheme assets at beginning of year	5,114	4,731
Expected return on scheme assets	299	286
Employee contributions	2	1
Employer contributions*	92	148
Actuarial (losses) gains	(3)	150
Benefit payments	(215)	(202)
Fair value of scheme assets at end of year	5,289	5,114

* The contributions include deficit funding and ongoing contributions.

Notes on the financial statements (continued)

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

	2007 £m	2006 £m
Pension credit (charge)		
Operating charge – current service cost	(52)	(61)
Finance income (expense):		
Interest on pension scheme liabilities	(255)	(246)
Expected return on pension scheme assets**	299	286
	44	40
Total pension charge	(8)	(21)
Less: PSPS amount attributable to Prudential plc	12	13
	4	(8)
Amount attributable to the Company's with-profits fund	10	(1)
Amount attributable to the Company's shareholders' funds	(6)	(7)
	4	(8)

Actuarial gains (losses)	**2007 £m**	2006 £m	2005 £m	2004 £m
Actual less expected return on scheme assets ** (0%, 3%, 11%, 3% of pension scheme assets)	(3)	150	533	112
Experience gains (losses) on scheme liabilities (0%, 0% 0%,0% of the present value of scheme liabilities)	(14)	18	(1)	(21)
Changes in assumptions underlying the present value of scheme liabilities*	307	254	(453)	(136)
Total actuarial gains (losses) (6%, 8%, 2%, (1%) of the present value of the scheme liabilities)	290	422	79	(45)
Less: PSPS amounts attributable to the Prudential plc	(91)	(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	-
	199	304	110	(35)
Amount attributable to the Company's with-profits fund	205	288	118	(37)
Amount attributable to the Company's shareholders' funds	(6)	16	(8)	2
	199	304	110	(35)

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

** The total actual return on scheme assets for both PSPS and SAPS is £296m (2006: £436m) of which £200m (2006: £314m) relates to the amounts attributable to the Company's with-profits funds.

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 credit of £10m (2006: charge of £1m) and actuarial gains of £205m (2006: £288m) 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 £59m 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 £6m (2006: £7m) attributable to the Company's shareholders' funds are included in the non-technical account. The actuarial losses before tax attributable to the Company's shareholders' funds of £6m (2006: actuarial gains of £16m) 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 2007 for the Company amounted to £4m (2006: cumulative actuarial gains of £10m).

Notes on the financial statements (continued)

The table below shows the sensitivity of the PSPS liabilities at 31 December 2007 of £4,361m (2006: £4,607m) to changes in discount rates, inflation rates and mortality assumptions.

Assumption	**Change in assumption**	**Impact on PSPS scheme liabilities on FRS17 basis**
2007		
Discount rate	Decrease by 0.2% from 5.9% to 5.7%	Increase scheme liabilities by 3.5%
Discount rate	Increase by 0.2% from 5.9% to 6.1%	Decrease scheme liabilities by 3.4%
Rate of inflation	Decrease by 0.2% from 3.3% to 3.1 with consequent reduction in salary increases	Decrease scheme liabilities by 1.3%
Mortality rates	Reduce rates from 100% of table to 95%	Increase liabilities by 1.2%

Assumption	Change in assumption	Impact on scheme liabilities on IAS 19 basis
2006		
Discount rate	Decrease by 0.2% from 5.2% to 5.0%	Increase scheme liabilities by 3.6%
Discount rate	Increase by 0.2% from 5.2% to 5.4%	Decrease scheme liabilities by 3.4%
Rate of inflation	Decrease by 0.2% from 3.0% to 2.8% with consequent reduction in salary increases	Decrease scheme liabilities by 1.3%
Mortality rates	Reduce rates from 100% of table to 95%	Increase liabilities by 1.2%

Total employer contributions expected to be paid into PSPS and SAPS for the year ending 31 December 2008 amounts to £81m.

Defined Contribution Pension Schemes

The Company operates defined contribution schemes in Hong Kong. The cost of these contributions was £1.0m (2006: £1.2m). £0.2m was outstanding at 31 December 2007 (2006: £0.2m).

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.

The Group Performance Share Plan (GPSP) is the incentive plan in which all executive directors and other senior executives within the Prudential Group, of which the Company is a part, can participate. This scheme was established as a replacement for the Restricted Share Plan (RSP) under which no further awards could be made after March 2006. Awards are granted either in the form of a nil cost option, conditional right over shares, or such other form that shall confer to the participant an equivalent economic benefit, with a vesting period of three years. The performance measure for the awards is that Prudential's Total Shareholder Return (TSR) outperforms an index comprising of peer companies. Vesting of the awards between each performance point is on a straight-line sliding scale basis. Participants are entitled to the value of reinvested dividends that would have accrued on the shares that vest. Shares are currently purchased in the open market by a trust for the benefit of qualifying employees.

The RSP was, until March 2006, the 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 was a deferment period of three years at the end of which the award vested to an extent that depended on the performance of the Group's shares including notional reinvested dividends and on the Group's underlying financial performance. After vesting, the option may 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. The RSP replaced the executive Share option Scheme in 1995 and all options under this plan had been exercised at 31 December 2005.

Notes on the financial statements (continued)

No rights were granted in the RSP if the Company's TSR performance as ranked against the comparator group is below 50th percentile. An option of 25 per cent of the maximum award is made. The maximum grant is made only if the TSR ranking of the Company is 20th percentile or above. Between these points, the size of the grant of option made is calculated on a straight-line sliding scale.

The BUPP is an incentive plan created to provide a common framework under which awards would be made to senior employees. Awards under this plan in 2006 and 2007 were based on growth in Shareholder Capital Value on the European Embedded Value (EEV) basis with performance measured over three years. Upon vesting, half of the vested award is released as shares and the other half released in cash. Participants are entitled to receive the value of reinvested dividends over the performance period for those shares that vest. The growth parameters for the awards are relevant to each region and vesting of the awards between each performance point is on a straight-line sliding scale basis.

UK-based executive directors are eligible to participate in the Prudential HM Revenue and Customs (HMRC) approved UK Savings Related Share Option Scheme (SAYE scheme) and the Asia-based executive director can participate in the equivalent International SAYE scheme. The schemes allow employees to save towards the exercise of options over Prudential plc shares, at an option price set at the beginning of the savings period at a discount of up to 20 per cent to the market price. Savings contracts may be up to £250 per month for three or five years, or additionally in the UK scheme seven years. On maturity at the end of the set term, participants may exercise their options within six months of the end of the savings period and purchase Prudential plc shares. If an option is not exercised within six months, participants are entitled to a refund of their cash contributions plus interest if applicable under the rules. Shares are issued to satisfy options that are exercised. No options may be granted under the schemes if the 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 ordinary share capital at the proposed date of grant.

UK-based executive directors are also eligible to participate in the Company's HMRC approved Share Incentive Plan (SIP) which allows all UK-based employees to purchase shares of Prudential plc (partnership shares) on a monthly basis out of gross salary. For every four partnership shares bought, an additional matching share is awarded, purchased on the open market. Dividend shares accumulate while the employee participates in the plan. Partnership shares may be withdrawn from the scheme at any time. If the employee withdraws from the plan within five years the matching shares are forfeit and if within three years, dividend shares are forfeit.

The 1,000 Day LTIP plan was a Prudential Group, UK insurance operations performance-based plan in which the UK Remuneration Committee could, at any time up to 5 October 2005, select employees of the Company at its absolute discretion, for participation in the plan. The performance period was 1,000 days and, based on 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 2007 and 2006 were as follows:

	2007		2006	
Options outstanding (including conditional options)	**Number of options**	**Weighted average exercise price £**	Number of options	Weighted average exercise price £
Beginning of year:	**357,106**	**3.10**	513,288	1.83
Granted	**539,813**	**0.90**	186,069	3.73
Exercised	**(49,675)**	**3.33**	(129,061)	2.83
Forfeited	**(219,607)**	**0.42**	(116,802)	0.71
Expired	**(109,541)**	**2.22**	(96,388)	0.80
End of year	**518,096**	**1.98**	357,106	3.10
Options immediately exercisable, end of year	**10,065**	**3.43**	2,722	4.83

The weighted average share price of Prudential plc for the year ended 31 December 2007 was £7.15 compared to £6.25 for the year ended 31 December 2006.

Movements in share awards outstanding under the Group's share-based compensation plans relating to Prudential plc shares at 31 December 2007 and 2006 were as follows:

	2007	2006
Awards outstanding	**Number of awards**	Number of awards
Beginning of year:	**124,017**	61,256
Granted	**196,362**	153,321
Exercised	**(62,258)**	(89,092)
Forfeited	**(93,134)**	(1,468)
Expired	**-**	-
End of year	**164,987**	124,017

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2007.

	Outstanding			Exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	Number exercisable	Weighted average exercise prices £
Between £0 and £1	305,195	8.75	0.00	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	9,597	0.92	2.66	-	-
Between £3 and £4	28,515	1.36	3.63	10,065	3.43
Between £4 and £5	81,258	2.23	4.57	-	-
Between £5 and £6	93,294	3.08	5.60	-	-
Between £6 and £7	237	1.42	6.17	-	-
	518,096	6.15	1.98	10,065	3.43

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 2006.

	Outstanding			Exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices £	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
	357,106	4.23	3.10	2,722	4.83

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

2007			2006		
Weighted average fair value			Weighted average fair value		
GPSP £	**Other options £**	**Awards £**	RSP £	Other options £	Awards £
4.69	2.47	7.48	4.79	1.96	-

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

	2007		2006	
	GPSP	**Other options**	RSP	Other options
Dividend yield (%)	2.32	2.32	2.64	2.64
Expected volatility (%)	26.64	25.88	25.48	34.32
Risk-free interest rate (%)	5.67	5.22	4.46	4.69
Expected option life (years)	3.00	3.15	3.00	3.20
Weighted average exercise price (£)	-	5.60	-	5.11
Weighted average share price (£)	7.64	7.47	7.16	6.52

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 GPSP. For the GPSP 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

	2007 **£**	2006 £
Aggregate emoluments	**3,270,820**	2,691,345
Aggregate amounts receivable (excluding shares) under long term incentive schemes	**492,083**	74,823
Compensation for loss of office	**-**	240,875
Excess retirement benefits:		
Current directors	**156,077**	103,640
Past directors	**-**	19,345
	3,918,980	3,130,028
Highest Paid Director		
Aggregate emoluments and amounts receivable (excluding shares) under long term incentive schemes	**1,320,483**	1,027,236

One director (2006: Nil) exercised share options during the year. Six directors (2006: nine) were entitled to shares under Prudential's main long-term incentive scheme and six directors (2006: seven) were entitled to retirement funds under defined benefit schemes. Following A-day no director has been entitled to benefits under money purchase schemes (2006: one, pre- A-Day). The highest paid director did not exercise any share options and did not receive any shares under long-term incentive schemes. The highest paid director in 2006 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:

	2007 £m	2006 £m
Audit services		
Fees payable to KPMG for the audit of the Company's accounts	**1.4**	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	**0.9**	1.7
	2.3	2.8

13. Intangible assets

	Goodwill £m	Licence £m	Total £m
Balance at beginning of year	34	134	168
Amortised in year			
Charged to non-technical account	(34)	-	(34)
Charged to the long-term business technical account	-	(11)	(11)
Balance at end of year	-	123	123

The goodwill arose on the purchase by the Company of the Scottish Amicable Life Assurance Society on 30 September 1997 and has been 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 has been amortised from 1 January 1998 over a period of 10 years.

Notes on the financial statements (continued)

14. Land and buildings

	2007 £m	2006 £m
Current value		
Freeholds	**7,075**	6,816
Leaseholds with a term of over 50 years	**2,248**	3,865
Leaseholds with a term of less than 50 years	**264**	266
	9,587	10,947
Cost	**5,342**	5,609

The value of land and buildings occupied by the Company amounted to £124m (2006: £142m)

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

Freehold and leasehold land and buildings

	2007 £m	2006 £m
At cost	**5,342**	5,609
Aggregate depreciation	**(1,341)**	(1,355)
Net book value based on historical cost	**4,001**	4,254

15. Investments in group undertakings and participating interests

	Cost		**Current value**	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Shares in group undertakings				
Long-term fund investments	**1,782**	1,426	**4,060**	3,293
Shareholder investments	**856**	809	**1,494**	2,259
	2,638	2,235	**5,554**	5,552
Loans to group undertakings				
Long-term fund loans	**810**	913	**810**	913
Total	**3,448**	3,148	**6,364**	6,465

The principal subsidiary undertakings of the Company at 31 December 2007, all wholly owned:

	Class of shares held	Principal Activity	Country of Incorporation
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 Lifetime Mortgages Limited	Ordinary shares £1 Preference shares £1	Mortgage lending and administration	Scotland
Prudential Retirement Income Limited	Ordinary shares £1 Preference 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 Holdings Limited	A ordinary shares £1 50% holding	Private medical insurance	England and Wales

16. Other financial investments

	Cost		Carrying value	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Shares and other variable yield securities and units in unit trusts	**31,708**	28,792	**52,643**	51,184
Debt securities and other fixed income securities	**26,477**	23,263	**26,248**	23,167
Derivative assets	**67**	(270)	**347**	255
Loans secured by mortgages	**21**	21	**21**	21
Loans to policyholders secured by insurance policies	**63**	64	**63**	64
Other loans	**735**	820	**735**	820
Deposits with credit institutions	**5,246**	5,215	**5,246**	5,215
	64,317	57,905	**85,303**	80,726

The change in carrying value of other financial investments included in the Profit and Loss account was a loss of £1,339m (2006: £759m gain) analysed between a loss of £1,373m (2006: £743m gain) included in the Long-term business technical account and a gain of £34m (2006: £16m gain) included in the Non-technical account. The change in carrying value of £1,339m (2006: £759m) included a loss of £1,456m (2006: £2,059m gain) in respect of equity securities, a loss of £121m (2006: £1,377m loss) in respect of debt securities, a gain of £152m (2006: £116m loss) in respect of derivatives and a gain of £86m (2006: £193m gain) in respect of other financial instruments.

Amounts included in the above relating to listed investments:	**2007 £m**	2006 £m
Shares and other variable yield securities and units in unit trusts	**48,580**	49,053
Debt securities and other fixed income securities	**23,772**	20,744
	72,352	69,797

The table below analyses the derivative positions of the Company.

	2007 £m		2006 £m	
	Fair value assets	**Fair value liabilities**	Fair value assets	Fair value liabilities
Derivative financial instruments held to manage interest rate and currency profile:				
Interest rate swaps	**72**	**3**	20	12
Cross currency swaps	**7**	**4**	8	-
Currency exchange forward contracts	**110**	**458**	167	18
Interest rate swaptions	**20**	**-**	34	-
Bond futures	**4**	**7**	2	34
Credit Default Swaps	**36**	**11**	-	-
Derivative financial instruments held to manage market risk and efficient investment management:				
Equity futures	**9**	**10**	7	3
Total return swaps	**89**	**94**	17	129
Total	**347**	**587**	255	196

Notes on the financial statements (continued)

The nature and extent of the derivative financial instruments used by the Company in 2007 are similar to those used in 2006 and their use and notional amounts are disclosed in note 32.

17. Assets held to cover linked liabilities

	Cost		Current value	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Assets held to cover linked liabilities	**7,267**	7,261	**7,899**	7,863

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

	2007 £m	2006 £m
Amounts owed by fellow subsidiaries and holding company	**963**	78
Amounts owed by subsidiary companies	**126**	29
Tax recoverable	**126**	78
Other	**229**	142
	1,444	327

20. Tangible fixed assets

	Computer Equipment £m	Fixtures & Fittings £m	Total £m
Cost:			
At 1 January 2007	37	72	109
Exchange differences	-	-	-
Additions	-	2	2
Disposals	-	-	-
At 31 December 2007	**37**	**74**	**111**
Depreciation:			
At 1 January 2007	37	64	101
Exchange differences	-	-	-
Provided in the year	-	2	2
Disposals	-	-	-
At 31 December 2007	**37**	**66**	**103**
Net book value at 31 December 2007	**-**	**8**	**8**
Net book value at 31 December 2006	-	8	8

The charge for depreciation for the year ended 31 December 2006 was £4m.

21. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 14, £124,861m (2006: £120,484m) is attributable to the long-term business fund.

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 970,468,254 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 153,600,000 Ordinary Shares of 25p each were issued at par fully paid during the year. Consideration was is cash and the issuance was in respect of expanding the operations of the Company’s subsidiaries.

Notes on the financial statements (continued)

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 2007	1,313	535	992	2,840
Exchange adjustments	-	-	-	-
Revaluation of subsidiaries	161	-	-	161
Movement on transfer of subsidiary	(956)	-	-	(956)
Profit for the financial year	-	-	1,209	1,209
Dividends	-	-	(288)	(288)
Actuarial gain on the pension scheme net of related tax	-	-	(4)	(4)
Balance at 31 December 2007	518	535	1,909	2,962

	2007 £m	2006 £m
Analysis of profit and loss account:		
Distributable retained profit	**1,552**	635
Undistributable retained profit	**357**	357
	1,909	992

24. Fund for future appropriations

	2007 £m	2006 £m
Prudential Assurance Company with-profits fund (excluding SAIF)	**14,410**	13,990

25. Bank current accounts

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

26. Other creditors including taxation and social security

	2007 £m	2006 £m
Amounts owed to fellow subsidiaries	**30**	122
Amounts owed to subsidiary companies	**199**	108
Tax	**292**	330
Derivative liability (see note 16)	**587**	196
Other creditors	**848**	857
	1,956	1,613

Notes on the financial statements (continued)

27. Preference shares

	2007 £m	2006 £m
A preference shares of £1 each – see Note 22	**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 2007, in respect of the Company's joint venture (Prudential Health Holdings Limited), a £27m (2006: £10m) capital injection was made and £3m (2006: £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, a company within the Prudential Health Holdings Limited group, 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.

The 2007 year end Investment Return for asset shares is:

Return	With-Profits Sub Fund	High Reversionary Bonus fund	SAIF
Gross return	7.19%	n/a	6.51%
Net return	6.54%	6.04%	5.93%

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.

Notes on the financial statements (continued)

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 2007.

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 2007 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
SAIF Conventional With-Profits	AM92 / AF92	+1 / +1	70/70
SAIF/ex-SAL Accumulating With-Profits Life	AM92 / AF92	+1 / +1	70/70

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 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 the higher demand from financial institutions for these securities.

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.

Notes on the financial statements (continued)

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 24 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.

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.

Notes on the financial statements (continued)

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	£16 to £212 p.a. depending on the product type
Expense Inflation	3.75% p.a.

Compared with the 2006 valuation the assumptions regarding administration expenses have been revised to allow for actual and forecast costs.

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, for Industrial Branch whole of life and endowment assurances unclaimed after maturity date or policy anniversary after age 90 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 2007.

Notes on the financial statements (continued)

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Balance at start of the period	401	331
Changes to actuarial assumptions and method of calculation	71	108
Discount unwind	22	15
Redress to policyholders	(41)	(48)
Payment of administrative costs	(5)	(5)
Balance at end of the period	448	401

The Financial Ombudsman Service 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. 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.

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 £5m in the non-profit sub-fund

Notes on the financial statements (continued)

and £43m in SAIF were held at 31 December 2007 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 £5m in respect of mortgage endowment products mis-selling claims in the year ended 31 December 2007 and held a provision of £55m at 31 December 2007, 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 £45m at 31 December 2007, 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 £563m was held in SAIF at 31 December 2007, 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 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 continues to explore 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 2007 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.

32. Financial assets and liabilities

A. Financial instruments – designation and fair values

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.

2007	**Fair value through profit and loss £m**	**Loans and receivables £m**		**Total carrying value £m**	**Fair value £m**
Financial Assets					
Deposits with credit institutions	-	5,246		5,246	5,246
Shares and other variable yield securities and units in unit trusts	52,643	-		52,643	52,643
Debt securities and other fixed income securities (note iii)	26,248	-		26,248	26,248
Loans:					
Loans secured by mortgages	-	21		21	24
Loans to policyholders secured by insurance policies	-	63		63	63
Other loans	-	735		735	753
Derivative assets	347	-		347	347
Accrued investment income	-	642		642	642
Other debtors	-	1,318		1,318	1,318
Cash at bank and in hand	-	648		648	648
Total	**79,238**	**8,673**		**87,911**	**87,932**
	Fair value through profit and loss £m	**Amortised cost £m**	**ABI SORP/ FRS26 £m**	**Total carrying value £m**	**Fair value £m**
Financial Liabilities					
Amounts owed to credit institutions	-	63	-	63	63
Investment contracts with discretionary participation features (note i)	-	-	33,970	33,970	-
Investment contracts without discretionary participation features (note ii)	5,210	-	-	5,210	5,210
Deposits received from reinsurers	-	-	-	-	-
Creditors arising out of direct insurance operations	-	52	-	52	52
Creditors arising out of reinsurance operations	-	62	-	62	62
Other creditors	-	1,079	-	1,079	1,079
Derivative liabilities	587	-	-	587	587
Total (note i)	**5,797**	**1,256**	**33,970**	**41,023**	**7,053**

Notes on the financial statements (continued)

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:					
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
Cash at bank and in hand	-	937		937	937
Total	74,606	7,917		82,523	82,734
	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
Other creditors	-	1,087	-	1,087	1,087
Derivative liabilities	196	-	-	196	196
Total (note i)	4,561	1,264	34,081	39,906	5,825

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 2007, £537m (2006: £490m) of convertible bonds were included in debt securities. There were no convertible bonds included in borrowings.

(iv) Loans and receivables are reported net of allowance for loan losses of £4m (2006: £3m)

(v) For financial liabilities designated as fair value through profit and loss there was no impact on profit from movements in credit risk during 2007 (2006: £nil).

Determination of fair value

The fair values of the financial assets and liabilities as shown in the table above have been determined on the following bases.

The fair values of the financial instruments for which fair valuation is required under UK GAAP and which are in an active market are determined by the use of current market bid prices for quoted investments, or by using quotations from independent third parties, such as brokers and pricing services. If the market for a financial asset is not active, fair value is established 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 if applicable 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.

The fair value of borrowings is based on quoted market prices, where available.

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

Use of valuation techniques

At 31 December 2007, the Company's with-profits fund held investments with a fair value of £2,646m (2006: £2,452m) which were measured in full or in part using valuation techniques.

The majority of these investments are debt securities. Of the investments valued using valuation techniques, £1,380m (2006: £1,485m) related to debt securities These debt securities include private debt securities such as private placements, project finance, asset securitisations and local authority securities. The securities are mainly long-dated and not regularly traded and are valued internally using market standard practices. The majority of the debt securities above are valued using matrix pricing, which is based on assessing credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. Under matrix pricing, the debt securities are priced by taking the credit spreads on comparable quoted public debt securities and applied to the equivalent debt instruments factoring a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

The investments other than debt securities valued using valuation techniques relate to equity securities and other investments which included property and other partnerships in investment pools and venture investments. These investments are valued using valuation techniques which apply less of readily observable market factors and more non-observable factors than the matrix pricing technique as used for the majority of the debt securities.

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 2007 was a profit of £73m (2006: a loss of £13m). Since all of these investments are held in respect of the Company's with-profits fund, the overall shareholders' profit and loss account result is not directly affected by the change in the fair value of these investments. Changes in fair value of these investments for the with-profits fund are included in the technical account and reflected in the transfer to or from the fund for future appropriations.

Interest income and expense

The interest income on financial assets not at fair value through profit and loss was £374m for the year ended 31 December 2007 (2006: £288m).

The interest expense on financial liabilities not at fair value through profit and loss was £8m for the year ended 31 December 2007 (2006: £3m).

B. Market Risk

The financial assets and liabilities attaching to the Company's life assurance business are, to varying degrees, subject to market risk that may have a material effect on the profit or loss and equity.

Market risk is the risk that the fair value or future cash flows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value will fluctuate because of changes in market prices. Market risk comprises three types of risk, namely:
Interest rate risk: due to changes in market interest rates,
Currency risk: due to changes in foreign exchange rates, and
Other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or currency risk).

With-profits business
The shareholder results of the Company's with-profits business are sensitive to market risk only through the indirect effect of investment performance on declared policyholder bonuses. The investment assets of the Company's with-profits fund are subject to market risk. However, changes in their carrying value, net of the related changes to asset-share liabilities of with-profit contracts, affect the level of funds for future appropriations, which is accounted for as a liability, movements in its value do not affect shareholders' profit or shareholders' funds.

The shareholder results of the Company's with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business. This currently corresponds to one-ninth of the cost of bonuses declared.

Investment performance is a key driver of bonuses, and hence the shareholders' share of cost of bonuses. Due to the 'smoothed' basis of bonus declaration the sensitivity to investment performance in a single year is low. However, over multiple periods it is important.

SAIF
SAIF is a ring-fenced fund in which, apart from asset management fees, shareholders have no interest. Accordingly, the Company's profit and shareholders' funds are insensitive to the direct effects of market risk attaching to SAIF's assets and liabilities.

Shareholder-backed non-profit sub-fund
The Company's non-profit sub-fund principally comprises annuity business previously written by Scottish Amicable Life, credit life, unit-linked and other non-participating business. The financial assets covering the liabilities for those types of business are subject to market risk. The liabilities for annuity contracts are subject to market risk arising from changes in the returns of the attaching assets. Except mainly to the extent of any minor asset/liability duration mismatch, and exposure to credit risk, the sensitivity of the Company's non-profit sub-fund's annuity business' results to market risk for movements in the carrying value of liabilities and covering assets is broadly neutral on a net basis.

The liabilities of the unit-linked business change in line with the matching linked assets. Other liabilities of the Company's non-profit sub-fund are broadly insensitive to market risk.

The principal items affecting the results of the Company's non-profit sub-fund are mortality experience and assumptions and credit risk.

Notes on the financial statements (continued)

Interest rate risk

The following table shows an analysis of the classes of financial assets and liabilities and their 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.

2007	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	19	5,227	-	5,246
Debt securities and other fixed income securities	23,708	2,526	14	26,248
Loans:				
Loans secured by mortgages	20	1	-	21
Loans to policyholders secured by insurance policies	29	34	-	63
Other loans	33	702	-	735
Derivative asset	84	-	263	347
Cash at bank and in hand	-	-	648	648
	23,893	**8,490**	**925**	**33,308**
Financial Liabilities				
Amounts owed to credit institutions	49	14	-	63
Investment contracts without discretionary participation features	-	-	5,210	5,210
Derivative liabilities	14	-	573	587
	63	**14**	**5,783**	**5,860**

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:				
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
Cash at bank and in hand	-	-	937	937
	26,016	3,265	1,198	30,479
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

Notes on the financial statements (continued)

Liquidity Analysis

2007	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	5,246	-	-	-	-	-	-	5,246
Debt securities and other fixed income securities	524	5,696	6,772	2,855	2,420	7,894	87	26,248
Loans:								
Loans secured by mortgages	-	-	-	-	21	-	-	21
Loans to policyholders secured by insurance policies	6	28	-	-	-	-	29	63
Other loans	21	106	494	21	18	75	-	735
Derivative assets	147	98	62	21	2	17	-	347
Cash at bank and in hand	648	-	-	-	-	-	-	648
	6,592	**5,928**	**7,328**	**2,897**	**2,461**	**7,986**	**116**	**33,308**
Financial Liabilities								
Operational borrowings	2	61	-	-	-	-	-	63
Derivative liabilities	554	27	2	-	-	4	-	587
	556	**88**	**2**	**-**	**-**	**4**	**-**	**650**

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:								
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
Cash at bank and in hand	937	-	-	-	-	-	-	937
	7,003	5,779	7,037	2,263	2,633	5,491	273	30,479
Financial Liabilities								
Operational borrowings	-	60	-	-	-	-	-	60
Derivative liabilities	74	117	4	1	-	-	-	196
	74	177	4	1	-	-	-	256

The table below shows the maturity profile for investment contracts on an undiscounted basis to the nearest billion. This maturity profile has been based on the cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing the EEV basis results.

	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	Total carrying value
	£bn	£bn	£bn	£bn	£bn	£bn	£bn
2007							
Life assurance investment contracts	**3**	**12**	**16**	**16**	**16**	**25**	**88**
2006							
Life assurance investment contracts	2	10	13	12	14	27	78

This table has been prepared on an undiscounted basis and accordingly the amounts shown for life assurance investment contracts differ from those included in the balance sheet. Durations of long-term

Notes on the financial statements (continued)

business contracts, covering both insurance and investment contracts, on a discounted basis are included below.

Durations of long-term business contracts on a discounted basis:

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. 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:

2007	With-profits business			Other		
	Insurance contracts	Investment contracts	Total	Insurance contracts	Investment contracts	Total
	%	%	%	%	%	%
0-5 years	47	25	38	32	33	32
5-10 years	27	23	26	24	22	23
10-15 years	13	19	16	18	19	18
15-20 years	7	15	10	12	14	13
20-25 years	4	11	6	7	5	7
Over 25 years	2	7	4	7	7	7

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 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.

Sensitivity to interest rate movement

As described above, the net exposure to interest rate movement for the Company is very substantially ameliorated by virtue of the close matching of assets with appropriate duration to the liabilities.

The close matching by the Company of assets of appropriate duration to its non-profit sub fund's annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and UK GAAP is not the same, with contingency reserves and some other margins for prudence within the assumptions required under the FSA regulatory solvency basis not included for UK GAAP reporting purposes. As a result UK GAAP's shareholders' funds are higher than regulatory capital and therefore more sensitive to interest rate risk.

Notes on the financial statements (continued)

The estimated sensitivity of the shareholder-backed business to a movement in interest rates (including assumed investment returns for all asset classes, market values of debt securities and all risk discount rates) of 1% as at 31 December 2007 and 2006 is as follows:

	2007		2006	
	Fall of 1% £m	Rise of 1% £m	Fall of 1% £m	Rise of 1% £m
Carrying value of debt securities and derivatives	185	(181)	147	(147)
Long term business provision	(173)	146	(142)	120
Related tax effects	(3)	10	(2)	8
Net sensitivity of profit after tax and shareholders' funds	9	(25)	3	(19)

Currency Risk

As at 31 December 2007, the Company held 39% and 3% (2006: 36% and 5%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency.

The financial assets, of which 93% (2006: 92%) are held by the with-profit fund, allow the fund to obtain exposure to foreign equity markets.

The financial liabilities, of which 87% (2006: 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.

Other Price Risk – Equities

In addition the shareholder backed portfolio of the Company includes equity securities. Excluding any second order effects on the measurement of liabilities for future cash flow to the policyholder, a 10% fall in their value would have given rise to a £1m and £0.4m reduction in pre-tax profit for 2007 and 2006. After related deferred tax there would have been an £0.7m and £0.3m reduction in shareholder's equity at 31 December 2007 and 2006 respectively.

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.

Notes on the financial statements (continued)

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 2007 and 31 December 2006:

2007	**Notional amount on which future payments are based**	
	Asset	**Liability**
	£m	**£m**
Cross-currency swaps	61	55
Equity index call options	-	23
Swaptions	1,125	1,125
Futures	1,904	2,176
Forwards	16,984	17,367
Single stock options	-	-
Credit default swaps	4,181	59
Total return swaps	956	956
Interest rate swaps	2,559	2,761

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

Debt Securities and Other Fixed Income Securities

The following table summarises by rating the securities held by the Company as at 31 December 2007.

	With-profits sub fund	**Other funds**	**Total 2007**
	£m	£m	£m
S&P – AAA	8,330	834	9,164
S&P – AA+ to AA-	2,331	231	2,562
S&P – A+ to A-	5,254	436	5,690
S&P – BBB+ to BBB-	3,299	154	3,453
S&P – Other	849	-	849
	20,063	1,655	21,718
Moody's – Aaa	688	19	707
Moody's – Aa1 to Aa3	221	13	234
Moody's – A1 to A3	393	26	419
Moody's – Baa1 to Baa3	220	17	237
Moody's – Other	68	-	68
	1,590	75	1,665
Fitch	238	18	256
Other	2,554	55	2,609
Total debt securities and other fixed income securities	24,445	1,803	26,248

In the table above S&P ratings have been used where available. For securities where S&P ratings are not immediately available those produced by Moody's and then Fitch have been used as an alternative.

Where no external ratings are available internal ratings produced by the Prudential Group's asset management operations, which are prepared on a comparable basis to external ratings, are used where possible. Of the total debt securities held at 31 December 2007 which are not externally rated, £873m were internally rated AAA to A-, £1,427m were internally rated BBB+ to B- and £309m were unrated. The majority of the unrated debt security investments were held by the Company's with-profits fund and relate to convertible debt which is not covered by rating analysts or have an internal rating attributed to it.

Notes on the financial statements (continued)

As detailed in section B the primary sensitivity of profit or loss and shareholders' equity of the Company relates to non-linked shareholder-backed business which covers the "other funds" in the table above.

Loans and receivables

Of the total loans and receivables held £3m (2006: £2m) are past their due date but have not been impaired. All the loans and receivables that are past due but not impaired are less than 1 year past their due date for both 2007 and 2006. The Company expects full recovery of these loans and receivables. Financial assets that would have been past due or impaired had the terms not been renegotiated amounted to £Nil (2006: £Nil).

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 amounts above the fair value of the loaned securities required to be held as collateral by the agreements, depend 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 2007, the Company had lent £7,838m (2006: £5,502m) of securities and held collateral under such agreements of £8,279m (2006: £5,754m).

At 31 December 2007, 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, £637m (2006: £586m), together with accrued interest.

Collateral and pledges under derivative transactions

At 31 December 2007, the Company had pledged £56m (2006: £89m) for liabilities and held collateral of £52m (2006: £6m) in respect of over-the-counter derivative transactions.

Reinsurer's share of technical provisions

Of the reinsurer's share of technical provisions of £15,339m at 31 December 2007, 2% of the balance relates to companies outside of the Prudential Group and of this 84% of the balances were from reinsurers with S&P's rating of AA- and above. Similar conditions existed at 31 December 2006. The majority of the reinsurers' share of technical provisions relate to cessions to subsidiaries of the Company or other group companies. See Note 18.

E. 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 fair value or future cashflows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value will fluctuate because of changes in market prices.

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.

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.

33. Capital Requirements and Management

Regulatory capital requirements apply at both an individual company level and at the Prudential Group level, of which the Company is a part, for life assurance and investment management business. The Prudential Group is currently subject to the solvency requirements of the Insurance Groups Directive (IGD) as implemented by the FSA. Under the IGD a parent company continuous solvency test is applied: Under this test the surplus unrestricted capital held in each of the regulated subsidiaries, including the Company, is aggregated with the free assets of non-regulated subsidiaries. From this total, Prudential Group borrowings are deducted, other than subordinated debt issues which qualify as capital.

In addition to obligations under subsidiary and Prudential Group regulatory requirements, the Prudential Group applies an economic framework to its management of capital. Economic capital provides a realistic and consistent view of the Group's capital requirements, allowing for diversification benefits.

At the Company level, the FSA rules which govern the prudential regulation of insurance form part of the Prudential Sourcebook for Insurers, the General Prudential Sourcebook and Interim Prudential Sourcebook for Insurers. Overall, the net requirements of the General Prudential Sourcebook are intended to align the capital adequacy requirements for insurance business more closely with those of banking and investment firms and building societies, for example, by addressing tiers of capital, rather than looking at net admissible assets. An insurer must hold capital resources equal at least to the Minimum Capital Requirement (MCR).

The Prudential Sourcebook for Insurers also contains rules on Individual Capital Assessments. Under these rules and the rules of the General Prudential Sourcebook all insurers must assess for themselves the amount of capital needed to back their business. If the FSA views the results of this assessment as

Notes on the financial statements (continued)

insufficient, it may draw up its own Individual Capital Guidance for a firm, which can be superimposed as a requirement.

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

Under FSA rules, insurers with with-profits liabilities of more than £500m must hold capital equal to the higher of the MCR and the Enhanced Capital Requirement (the "ECR"). The ECR is intended to provide a more risk responsive and "realistic" measure of a with-profit insurers capital requirements, whereas the MCR is broadly speaking equivalent to the previous required minimum margin under the Interim Prudential Sourcebook and satisfies the minimum EU Standards.

Determination of the ECR involves the comparison of two separate measurements of the firm's resources requirement, which the FSA refers to as the "twin peaks" approach. The two separate peaks are:

(i) the requirement comprised by the mathematical reserves plus the "Long-Term Insurance Capital Requirement" (the "LTICR"), together known as the "regulatory peak"; and
(ii) a calculation of the "realistic" present value of the insurer's expected future contractual liabilities together with projected "fair" discretionary bonuses to policyholders, plus a risk capital margin, together known as the "realistic peak".

Available capital of the WPSF, SAIF and DCPSF of £8.7bn (2006: £8.6bn) represents the excess of assets over liabilities on the FSA realistic basis. Unlike the previously discussed FRS 27 basis, realistic liabilities on the regulatory basis include the shareholders' share of future bonuses. These amounts are shown before deduction of the risk capital margin (RCM) which is estimated to be £2.0bn (2006: £1.8bn) at 31 December 2007.

The FSA's basis of setting the RCM is to target a level broadly equivalent to a Standard & Poor's credit rating of BBB and to judge this by ensuring there are sufficient assets to absorb a 1 in 200 year event. The RCM calculation achieves this by setting rules for the determination of margins to cover defined stress changes in asset values and yields for market risk, credit risk and termination risk for with-profits policies.

The Company has discretion in its management actions in the case of adverse investment conditions. Management actions encompass, but are not confined to, investment allocation decisions, levels of reversionary bonuses, crediting rates and total claim values. To illustrate the flexibility of management actions, rates of regular bonus are determined for each type of policy primarily by targeting them at a prudent proportion of the long-term expected future investment return on the underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by date of payment of the premiums or date of issue of the policy, if the accumulated annual bonuses are particularly high or low relative to a prudent proportion of the achieved investment return.

When target bonus levels change, the Company's board has regard to the overall financial strength of the long-term fund when determining the length of time over which it will seek to achieve the amended product target bonus level.

In normal investment conditions, the Company expects changes to regular bonus rates to be gradual over time and changes are not expected to exceed one per cent per annum over any year. However, discretion is retained as to whether or not a regular bonus is declared each year, and there is no limit on the amount by which regular bonus rates can be changed.

As regards smoothing of maturity and death benefits, in normal circumstances the Company does not expect most pay-out values on policies of the same duration to change by more than 10 per cent up or down from one year to the next, although some larger changes may occur to balance pay-out values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values (either sudden or over a period of years) and in such situations the Company's board may decide to vary the standard bonus smoothing limits to protect the overall interests of policyholders.

For surrender benefits, any substantial fall in the market value of the assets of the with-profits sub-fund would lead to immediate changes in the application of MVRs for accumulating with-profits policies, firstly to increase the size of MVRs already being applied and, secondly, to extend the range of policies for which an MVR is applied.

Notes on the financial statements (continued)

Non-Profit Sub-Fund

The available capital of £86m (2006: £132m) reflects the excess of regulatory basis assets over liabilities of the Company. The regulatory capital resources requirement of £240m (2006: £249m) is covered in part (as is permitted by the FSA Regulations) by assets in the shareholder funds. The available capital and capital resources requirement is monitored during the year. In addition, a realistic assessment of available capital and capital requirements sufficient to cover a 1 in 200 year event is undertaken. Additional capital is sought from the parent company as necessary.

The capital requirement required by regulation was maintained during the year.

The Company's capital position for life assurance businesses with reconciliations to shareholders' funds is shown below. Available capital for each fund is determined by reference to the FSA regulations at 31 December 2007 and 2006.

31 December 2007	SAIF £m	WPSF and DCPSF £m	Total with-profits fund £m	Non-profit sub-fund £m	Total life assurance £m	Shareholders' fund	Company total
Shareholders' equity							
Held outside long-term funds							
Net assets	-	-	-	-		2,997	2,997
Goodwill	-	-	-	-		123	123
Total	-	-	-	-		3,120	3,120
Held in long-term funds (note i)	-	-	-	172	172	-	172
Total shareholders' funds	-	-	-	172	172	3,120	3,292
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	14,410	14,410	-	14,410		
Shareholders' share of realistic liabilities	-	(4,178)	(4,178)	-	(4,178)		
Deferred acquisition costs of non-participating business and goodwill not recognised for regulatory reporting purposes	(4)	(16)	(20)	(138)	(158)		
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(530)	(530)	-	(530)		
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(1,117)	(1,117)	-	(1,117)		
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	4	149	153	52	205		
Total adjustments	-	8,718	8,718	(86)	8,632		
Total available capital resources of life assurance businesses on FSA regulatory bases	-	8,718	8,718	86	8,804		

Notes on the financial statements (continued)

31 December 2006	SAIF £m	WPSF and DCPSF £m	Total with-profits fund £m	Non-profit sub-fund £m	Total life assurance £m	Shareholders' fund	Company total
Shareholders' equity							
Held outside long-term funds:							
Net assets	-	-	-	-	-	2,803	2,803
Goodwill	-	-	-	-	-	168	168
Total	-	-	-	-	-	2,971	2,971
Held in long-term funds (note i)	-	-	-	160	160	-	160
Total shareholders' funds	-	-	-	160	160	2,971	3,131
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	13,990	13,990	-	13,990		
Shareholders' share of realistic liabilities	-	(4,000)	(4,000)	-	(4,000)		
Deferred acquisition costs of non-participating business and goodwill and licence not recognised for regulatory reporting purposes	(5)	(27)	(32)	(135)	(167)		
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(244)	(244)	-	(244)		
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(1,076)	(1,076)	-	(1,076)		
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	5	(24)	(19)	107	88		
Total adjustments	-	8,619	8,619	(28)	8,591		
Total available capital resources of life assurance businesses on FSA regulatory bases	-	8,619	8,619	132	8,751		

Notes

(i) The term shareholders' equity held in long-term funds refers to the excess of assets over liabilities attributable to shareholders of funds which are required by law to be maintained with segregated assets and liabilities.

(ii) Other adjustments to shareholders' equity and funds for future appropriation include amounts for the value of non-participating business for with-profits funds, deferred tax, admissibility and other items measured differently on the regulatory basis.

(iii) Insurance business accounted for as financial instruments under FRS26.

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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

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.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

M E Tucker
Chairman
27 March 2008

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 2007 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 60.

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 2007 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 2008