

Registered No: 15454

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

**Annual Report and Financial Statements for the Year Ended
31 December 2009**

**Final
Dated 26 March 2010**

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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

Registered office: Laurence Pountney Hill, London EC4R 0HH

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THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Directors

Mr T C Thiam (Chairman)
Mr D J Belsham
Mr A M Crossley
Mr R A Devey
Mr N A Nicandrou
Mr F A O'Dwyer

Secretary

Miss S D Windridge

Auditor

KPMG Audit Plc, London

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009

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 2010.

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. There are two types of bonuses – "annual" and "final". Annual bonuses are declared once a year, and are determined as a prudent proportion of the long-term expected future investment return on the underlying assets. Once credited, annual bonuses are guaranteed in accordance with the terms of the particular product. In contrast, "final" bonuses are only guaranteed until the next bonus declaration, and are primarily determined on the actual smoothed investment return achieved over the life of the policy. 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 2009 in the UK, the Company continued to focus on realising value from the opportunities created by the increasing need for retirement solutions. The Company competes in selected areas of the UK's retirement savings and income markets where it believes it can generate attractive returns from capital employed. The Company continues to place great emphasis on the disciplined deployment of capital to seize opportunities that play to the core strengths of the business.

The UK is characterised by an ageing population and the concentration of wealth in the mass affluent and high net worth sectors - a combination that positions the retirement and near-retirement segments as the fastest growing in the marketplace. Low savings rates and high levels of consumer debt, coupled with an increasing shift in responsibility for providing retirement income away from Government and employers towards individuals, have resulted in individuals in the UK being inadequately provided for during increasingly long periods of retirement.

The Company has a unique combination of competitive advantages including its longevity experience, multi-asset investment capabilities, strong brand and financial strength. These put the Company in a strong position to continue to generate attractive returns.

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

The Company distributes products through both direct and intermediated channels. The direct channel primarily focuses on capturing internal pension vestings. The intermediated channel distributes products through retail intermediaries, strategic partners and through employee benefit consultants and consulting actuaries. Participation within the intermediary market is selective, concentrating on those advisers who focus on value and building client relationships. Significant progress is being made in growing the sales teams and improving productivity. In addition, the Company is focusing on developing deeper and better relationships with key accounts and through partnership relationships and has been successful in gaining a number of new panel positions since the beginning of 2009.

The Company's with-profits business performed particularly strongly during 2009, including PruFund, showing once again that with-profits, when invested in an actively managed and financially strong fund like the Company's, continues to be an attractive medium to long-term investment, offering strong annualised returns compared with other investment options. In 2009, the Company extended further the PruFund range of investments with the launch of the PruFund Cautious series to sit alongside the PruFund Growth series within the on-shore bond wrapper.

The Company has a significant pipeline of internal vestings annuity business from maturing individual and corporate pension policies, which is expected to remain strong at least over the next ten years.

In the first quarter of 2009, the Company launched a new Income Choice Annuity which allows customers to choose an income between a defined maximum and minimum level, with the option of re-setting this every two years. It also provides an opportunity for pension income to grow because the product is backed by the Company's strong with-profits fund.

Within corporate pensions the Company continues to focus principally on the opportunities from the substantial existing Defined Contribution book of business as well as providing Additional Voluntary Contribution arrangements to the public sector.

Within individual pensions sales of the Flexible Retirement Plan, the Company's factory-gate priced product, continues to grow along with the sales of the income drawdown product.

In the wholesale market, the Company aims to participate selectively in bulk annuity and back-book buyouts using its financial strength, superior investment track record and annuitant mortality risk assessment capabilities. There continues to be a significant pipeline of potential wholesale deals, but maintaining a strict focus on value means that the Company will only participate in transactions that meet its strict return on capital requirements.

In 2007, Prudential Group, of which the Company is a part, announced an agreement with Capita to outsource a large proportion of its in-force and new business policy administration, which is an important element in achieving the Group's UK business total cost savings target. The agreement commenced in April 2008. The contract helps deliver the long-term cost savings strategy by removing fixed costs from the business and achieving significant operating efficiencies. The Capita contract also 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.

The Company's Hong Kong Branch is a leading life insurer with strong brand recognition in the Hong Kong market. The branch is dedicated to meeting the different needs of its customers by providing a comprehensive range of insurance services. The range of products include life insurance, general insurance, employee benefits, investment, health and protection products supported by outstanding customer service. Retirement and health are currently two key strategic initiatives to help Hong Kong people lead financially secure lives and to meet customer need for increased medical protection.

Solvency II

Solvency II, the fundamental review of the capital adequacy regime for the European insurance industry, aims to establish a revised set of EU-wide capital requirements and risk management standards that will replace the existing Solvency I requirements. Solvency II will set out new EU-wide requirements for insurers with a view to the reducing the likelihood of an insurer failing. The strengthened regime should reduce the possibility of consumer loss or market disruption in insurance. The Prudential Group has in place an integrated programme, of which the Company is an integral part, to prepare for Solvency II to consider processes and requirements on a Group-wide and Company basis. This programme aligns

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

with the "3 Pillars" of Solvency II, namely minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements, and is designed to embed the Solvency II principles within the business.

Risks & uncertainties

As a provider of insurance services, the Company's business is the managed acceptance of risk. The Company is a wholly owned subsidiary of the Prudential Group and is subject to the Group's internal control and risk management processes as detailed in the Group Governance Manual and Group Risk Framework. The control procedures and systems established within the Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. They can only provide reasonable and not absolute assurance against material misstatement or loss, and focus on aligning the levels of risk-taking with the achievement of business objectives.

The Group's risk governance framework requires all businesses and functions within the Group, including the Company, to establish processes for identifying, evaluating and managing key risks. The risk governance framework is based on the concept of three lines of defence: risk management, risk oversight and independent assurance.

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

- 1) The business is inherently subject to market fluctuations and general economic conditions.
 - a) Uncertain or negative trends in international economic and investment climates which have adversely affected the Company's business and profitability could be repeated or prolonged, or could worsen. The adverse effect of such trends, including the unprecedented market dislocation across asset classes and geographical markets witnessed in 2008 and in the first half of 2009, have been and would be felt principally through the following:
 - investment impairments or reduced investment returns could impair its ability to write significant volumes of new business as a result of market volatility, which would have a negative impact on the Company's assets under management and profit;
 - higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses, as experienced during 2008 and 2009, when illiquidity and credit spreads reached all-time highs;
 - failure of any of the counterparties with which the Company enters a variety of transactions, including derivatives, in the normal course of business, to discharge their obligations, or where adequate collateral is not in place, could have an adverse impact on the Company's results; and
 - in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain value and estimates of value require substantial elements of judgement, assumptions and estimates (which may change over time). Increased illiquidity also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline.
 - b) Estimates of financial instruments' value are difficult 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. For all lines of business, fluctuations in financial risk factors will affect the Company's results. During 2008 and for the first half of 2009, the Company has had to operate within a challenging background of unprecedented volatility in capital and equity markets, interest rates and widespread economic uncertainty. This has led, among other things, to reduced consumer spending, an increase in unemployment, and consequently reduced liquidity, requiring the intervention of the Bank of England via a quantitative easing programme to restore credit facilities in the market.

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

- 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.
 - a) Changes in government policy, legislation (including tax) 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. Furthermore, as a result of the recent interventions by governments in response to global economic conditions, it is widely expected that there will be a substantial increase in government regulation and supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transaction structure, and enhanced supervisory powers.
 - b) 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.
 - c) 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 several issues affecting the financial services industry could have a negative impact on the Company's reported results or on its reputation or on its relations with current and potential customers.
 - a) 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.
 - b) Regulators are moving towards a regime of principles-based regulation which brings an element of uncertainty. Regulators are increasingly interested in the approach that product providers use to select third-party distributors. In some cases product providers can be held responsible for the deficiencies of third-party distributors.
- 4) Litigation and disputes may adversely affect the Company's profitability and financial condition.
 - a) 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 provisioned 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 operations 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.
 - a) 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

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

- strength and name recognition, investment management performance, historic bonus levels, developing demographic trends and customers' appetite for certain savings products.
- b) 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, Lloyds Banking Group and Standard Life.
 - c) The Company believes competition may 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.
- a) The Company's financial strength and credit ratings, which are used by the market 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.
- 7) Adverse experience in the operational risks inherent in the Company's business could have a negative impact on its results of operations.
- a) 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 investment management, 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, but their performance is monitored carefully.
 - b) 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 reserving process could have an impact on its results during the effective period. The Company has not experienced or identified any operational risks in its systems or processes during 2009, or which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.
- 8) Adverse experience against the assumptions used in pricing products and reporting business results could significantly affect the Company's results of operations.
- a) 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 continue to 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.

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

- b) 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.
- a) 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 14 to 16, show a profit on ordinary activities before tax of £493m (2008: £555m). 2009 profits have decreased by £62m (11%). The variance is primarily due to £114m reduction in profits attributable to the with-profits business following the bonus rate reductions announced in the February 2009 bonus declaration and £118m reduction in profits arising from the quota share reinsurance agreement entered into with Prudential Retirement Income Limited in December 2008; the profits of £179m in 2008 were attributable to the 15% quota share of accumulated surplus, whereas the profit in 2009 arises only on the surplus arising in 2009. Partially offsetting these movements is a £109m increase in profits from the UK non with-profits business due to higher annuity profits, lower pension and protection losses and improved investment return. Also, the profits from the Hong Kong branch have increased by £58m mainly due to improved investment return in 2009 and a reduction in reserves following a change in the valuation interest rates. Commission received on Prudential-branded General Insurance products contributed £51m to the results in 2009, 16% per cent higher than the £44m commission received in 2008. This increase was due to the substantial advance commissions received on the transfer of the business to Churchill in 2002 being fully amortised in March 2008, so that commissions earned are now received in full.

The shareholders' funds of the Company total £3,699m (2008: £3,237m).

Sales on an APE basis (Regular Premiums plus 1/10th Single Premiums) are £890m, down 22% from £1,134m in 2008. 2008 included the quota share reinsurance agreement entered into with Prudential Retirement Income Limited in December 2008, which contributed £239m APE. Excluding this transaction, sales on an APE basis are 1% down on 2008. In the UK, market conditions remained challenging in 2009, with a 23% fall in the Retail Market in the twelve months to September (ABI statistics). In addition, the Company continues to maintain a strict focus on the disciplined use of capital and pricing to achieve its return on capital targets. Against this background, sales of individual annuities and corporate pensions were lower than in 2008. Sales of other product lines, such as offshore bonds, were impacted by continued market volatility. In Hong Kong, there were no sales of the single premium PruWealth product, following cessation in late 2008. These reductions in sales were partially offset by the continued strength of the Company's with-profits offering in the UK, in particular Prufund.

The Company's With-Profits Fund is the largest and one of the financially strongest in the UK, continuing to comfortably cover its regulatory solvency requirements. The Fund is supported by an Inherited Estate estimated at £6.4bn (as at 31 December 2009) which provides the working capital required to support the Fund for the long-term benefit of current and future policyholders.

The Company's With-Profits Life Fund investment performance compared with industry indices is shown in the table below.

Fund/Index	2009 Performance
Prudential Assurance Company Ltd With-Profits Fund (before tax)	18.7%
Prudential Assurance Company Ltd With-Profits Fund (after tax)	15.7%
FTSE All-Share index (total return)	30.1%
FTSE 100 index (total return)	27.3%
ABI UK – Balanced (up to 85% Equity) Managed-Life Fund	19.0%
ABI UK – Cautious (up to 60% Equity) Managed-Life Fund	16.0%
IPD UK All Property Monthly	2.2%

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

Underlying investment performance over the last five and ten years is shown in the table below.

Fund/Index	5 Years	10 Years
Prudential Assurance Company Ltd With-Profits Fund (gross cumulative return)	37.8%	66.3%
Prudential Assurance Company Ltd With-Profits Fund (net cumulative return)	34.5%	60.8%
FTSE All-Share index (total return)	36.8%	17.7%
FTSE 100 index (total return)	35.4%	9.0%
ABI UK – Balanced (up to 85% Equity) Managed-Life Fund	25.1%	13.7%
ABI UK – Cautious (up to 60% Equity) Managed-Life Fund	15.1%	19.2%
IPD UK All Property Monthly	5.0%	81.5%

The table below shows the asset mix of the Company's with-profits fund:

	2009	2008	2007
	per cent	per cent	per cent
UK equities	25	34	35
International equities	12	17	17
Fixed interest	40	29	28
Property	12	14	14
Alternative investments	5	5	3
Cash and other assets classes	6	1	3
Total	100	100	100

The Company's long-term fund is rated Aa2 (negative outlook) by Moody's, AA (negative watch) by Standard & Poor's and AA+ (negative watch) by Fitch as at the date of signing the accounts.

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 and Prudential Asia. 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 the Prudential Group and corporate responsibility (CR) is a philosophy that is firmly embedded in Prudential's operations around the world as an integral part of how the organisation does business. The organisation strives to minimise the social, ethical and environmental impact of its activities and to maximise the opportunities. The importance of engaging with stakeholders and responding to their concerns is recognised. To do this the organisation maintains a regular dialogue and conducts periodic research on the issues that matter most to them.

In 2009, financial institutions came under continued scrutiny as a result of the market turmoil. Insurance companies are, however, fundamentally different from banks because they invest in assets for the long-term. During the financial turmoil the organisation played a significant role to help stabilise the market by providing liquidity during difficult times to the benefit of the whole economy.

Insurance companies have a unique role in society by helping people manage uncertainty and plan for a more secure future. In this way, the organisation's commercial value is linked to the social value of what is offered to its customers.

The approach to CR is underpinned by the organisation's founding values of integrity, security and prudence. Throughout its 160-year history the organisation has been committed to helping its customers

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

safeguard their financial security and protect their families. This, together with the contribution to the well-being of the communities in which the organisation operates, is as strong today as it has always been.

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. In late 2008, the CR framework was enhanced to further drive sustainability performance, provide greater focus to programmes and activities, and to enable a more consistent approach to reporting. The CR activities are framed around five core themes:

1. Insightful and transparent products meeting customer needs
2. Best people for the best performing business
3. Protecting the environment
4. Supporting local communities
5. Accountability and governance

While the Group sets the overall strategy for CR, the framework gives the Company the flexibility to implement programmes that best meets its markets. This recognises that the people on the ground are closest to their customers, and their communities, and know best how to meet their needs and expectations.

The Prudential plc Board discusses the Group's CR performance at least once a year and also reviews and approves the Group CR Report and strategy on an annual basis. Below the Board, the Responsibility Committee comprises senior representatives from relevant Group functions and each of our core businesses, such as the Company. This committee is responsible for monitoring the Group's CR activities and for raising issues that need to be addressed.

Subsidiary undertakings and branches

Particulars of the Company's principal subsidiary undertakings at 31 December 2009 are shown on page 43 in note 16. At 31 December 2009 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 2009 is shown in the balance sheet on pages 18 and 19. The profit and loss account appears on pages 14 to 16.

Share Capital

There have been no changes in the Company's share capital during 2009 as shown on page 45 in note 23.

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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

Dividends

An interim dividend of £284m (2008: £482m) on the ordinary shares was paid on 9 April 2009. The directors have not declared a final dividend on the ordinary shares for 2009 (2008: £Nil).

A dividend on the A preference shares of £32,769 was paid on 8 May 2009 (2008: £29,165). 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 (2008: 21 days).

Directors

The present directors are shown on page 1.

Messrs O'Dwyer, Nicandrou and Devey were appointed as directors of the Company on 15 January 2009, 28 October 2009 and 16 November 2009 respectively. Mr Tucker and Mr Prettejohn resigned as directors of the Company on 30 June 2009 and 30 September 2009 respectively. There were no other changes during the year.

Political and Charitable Donations

During 2009 the Hong Kong branch made donations of £45,324 (2008: £28,761) as follows: £40,380 was donated to the Hong Kong Foundation of Youth, ORBIS International Blindness Elimination Programme £2,472, Hospital Authority Charitable Foundation £1,236, Community Business Limited £824 and Helping Hand £412. This is broken down as follows: Education £40,380; Social and Welfare £4,944.

No donations were made for political purposes.

Disclosure 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 418 of the Companies Act 2006.

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 33 (E) on page 66.

Further information on the use of derivatives by the Company is provided in note 33 (C) on page 63.

Auditor

The directors appointed KPMG Audit Plc as auditor of the Company on 6 May 2009. An ordinary resolution of the Company for the re-appointment of KPMG Audit Plc as auditor of the Company will be proposed to the members of the Company in accordance with Section 485(4) of the Companies Act 2006.

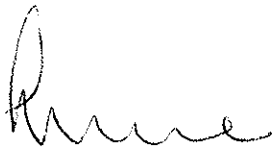
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DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

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 for the directors, officers and employees of the Company to be indemnified in respect of liabilities incurred as a result of their office. 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 and other companies within the Group. These indemnities were in force during 2009 and remain in force.

On behalf of the Board of directors.

A handwritten signature in black ink, appearing to read 'S D Windridge', is positioned above the typed name and date.

S D Windridge
Secretary
26 March 2010

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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.

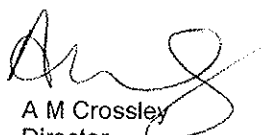
Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they 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 adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.



A M Crossley
Director
26 March 2010

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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 2009 on pages 14 to 70. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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

As explained more fully in the Directors' Responsibilities Statement set out on page 12, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Chris Moulder (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
1 Canada Square
Canary Wharf
London
E14 5AG

26 March 2010

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2009

Note	<u>General Business Technical Account</u>	<u>2009 £m</u>	<u>2008 £m</u>
2b	Gross premiums written	34	28
	Outward reinsurance premiums	<u>(4)</u>	<u>(3)</u>
	Premiums written, net of reinsurance	30	25
	Change in the provision for unearned premiums		
	Gross amount	-	<u>(2)</u>
	Earned premiums, net of reinsurance	<u>30</u>	<u>23</u>
	Claims paid		
	Gross amount	(21)	(18)
	Reinsurers' share	<u>4</u>	<u>4</u>
	Claims paid, net of reinsurance	(17)	(14)
	Change in provision for claims		
	Gross amount	4	(2)
	Reinsurers' share	<u>(4)</u>	<u>(4)</u>
	Net of reinsurance	-	(6)
	Claims incurred, net of reinsurance	<u>(17)</u>	<u>(20)</u>
5	Net operating expenses	(12)	(11)
2b	Balance on the general business technical account	<u>1</u>	<u>(8)</u>
	<u>Analysis:</u>		
	Continuing operations	1	2
9	Operations in run-off	-	(10)
		<u>1</u>	<u>(8)</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2009 (continued)

Note	<u>Long-term Business Technical Account</u>	<u>2009 £m</u>	<u>2008 £m</u>
2a	Gross premiums written	6,238	8,803
	Outward reinsurance premiums	(1,137)	(1,136)
	Earned premiums, net of reinsurance	<u>5,101</u>	<u>7,667</u>
3	Investment income	6,825	3,605
	Unrealised gains (losses) on investments	6,131	(21,853)
	Claims paid		
	Gross amount	(9,348)	(10,287)
	Reinsurers' share	1,065	1,010
	Claims paid, net of reinsurance	<u>(8,283)</u>	<u>(9,277)</u>
	Change in provision for claims		
	Gross amount	7	3
	Reinsurers' share	1	-
	Claims incurred, net of reinsurance	<u>(8,275)</u>	<u>(9,274)</u>
	Change in long-term business provision		
	Gross amount	(5,881)	13,395
	Reinsurers' share	1,195	(239)
		<u>(4,686)</u>	<u>13,156</u>
	Change in technical provision for linked liabilities	(1,207)	1,295
	Change in other technical provisions, net of reinsurance	<u>(5,893)</u>	<u>14,451</u>
5	Net operating expenses	(835)	(680)
6	Investment expenses and charges	(275)	(288)
7	Tax attributable to the long-term business	(852)	1,418
	Actuarial and other losses on pension schemes	(55)	(287)
	Transfer (to) from the fund for future appropriations	(1,580)	5,614
	Balance on the long-term business technical account	<u>292</u>	<u>373</u>

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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Profit and Loss Account for the year ended 31 December 2009 (continued)

Note **Non-Technical Account**

	<u>2009 £m</u>	<u>2008 £m</u>
Balance on the general business technical account	1	(8)
Balance on the long-term business technical account	292	373
7 Tax credit attributable to the balance on the long-term business technical account	111	137
2a Balance on the long-term business technical account before tax	<u>403</u>	<u>510</u>
3 Investment income	77	120
Unrealised loss on portfolio investments	(5)	(64)
Other income	54	41
Other charges	(37)	(44)
2c Total profit on other activities	<u>89</u>	<u>53</u>
Profit on ordinary activities before tax	<u>493</u>	<u>555</u>
7 Tax on profit on ordinary activities	(144)	(174)
Profit for the financial year	<u>349</u>	<u>381</u>

Except for the valuation of investments, 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, given the exemptions provided to insurance companies in FRS 3.31A, a note of the historical cost profits and losses for the year is not given.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Statement of Total Recognised Gains and Losses for the year ended 31 December 2009

Note

	<u>2009 £m</u>	<u>2008 £m</u>
Profit for the financial year	349	381
Other recognised gains and losses:		
24 Increase in surplus on revaluation of investments in shareholder subsidiaries	389	40
Exchange adjustments	(8)	6
Actuarial gain on pension scheme, net of related deferred tax	-	1
Reserve movement in respect of share-based payments	-	1
Other movements – transfer of Scottish Amicable Pension Scheme (SAPS) deficit from the Company to another Group Company	16	-
Total recognised gains relating to the financial year	746	429

Reconciliation of Movement in Shareholders' Funds for the year ended 31 December 2009

	<u>2009 £m</u>	<u>2008 £m</u>
Total recognised gains relating to the financial year	746	429
Dividends	(284)	(482)
Net movement in shareholders' funds	<u>462</u>	<u>(53)</u>
Shareholders' funds at beginning of year	<u>3,237</u>	<u>3,290</u>
Shareholders' funds at end of year	3,699	3,237
Included in Shareholders' funds are aggregate net foreign exchange differences as follows:		
Aggregate net foreign exchange differences included in opening Shareholders' funds	(6)	8
Net foreign exchange differences for the year	(2)	(2)
Aggregate net foreign exchange differences included in closing Shareholders' funds	(8)	6

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Balance sheet as at 31 December 2009

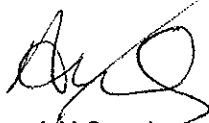
Note	<u>Assets</u>	<u>2009 £m</u>	<u>2008 £m</u>
14	Intangible assets		
	Licence	104	114
	Distribution rights	126	147
		<u>230</u>	<u>261</u>
	Investments		
15	Land and buildings	5,952	6,517
16	Investments in group undertakings and participating interests	6,243	6,116
17	Other financial investments	76,769	70,756
		<u>88,964</u>	<u>83,389</u>
18	Assets held to cover linked liabilities	7,648	6,538
19	Reinsurers' share of technical provisions		
	Provision for unearned premiums	2	2
	Long-term business provision	11,835	10,642
	Claims outstanding	22	26
	Technical provisions for linked liabilities	4,897	3,985
		<u>16,756</u>	<u>14,655</u>
	Debtors		
	Debtors arising out of direct insurance operations		
	Policyholders	50	62
	Intermediaries	10	10
	Debtors arising out of reinsurance operations	2,401	2,082
20	Other debtors	1,115	1,333
		<u>3,576</u>	<u>3,487</u>
	Other assets		
21	Tangible assets	7	8
26	Cash at bank and in hand	856	995
		<u>863</u>	<u>1,003</u>
	Prepayments and accrued income		
	Accrued interest and rent	600	575
	Deferred acquisition costs		
	General business	6	6
	Long-term business	161	164
	Accrued external dividends receivable	55	113
	Other prepayments and accrued income	110	115
		<u>932</u>	<u>973</u>
	Total assets (excluding pension asset)	<u>118,969</u>	<u>110,306</u>
11	Pension asset (net of related deferred tax)	46	72
22	Total assets (including pension asset)	<u>119,015</u>	<u>110,378</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Balance sheet as at 31 December 2009 (continued)

Note	<u>Liabilities</u>	<u>2009 £m</u>	<u>2008 £m</u>
	Capital and reserves		
23	Share capital	330	330
24	Revaluation reserve	947	558
24	Other reserves	536	536
24	Profit and loss account	1,886	1,813
		<hr/>	<hr/>
2c	Shareholders' funds - equity interests	3,699	3,237
		<hr/>	<hr/>
25	Fund for future appropriations	10,330	8,691
	Technical provisions		
	Provision for unearned premiums	16	18
31	Long-term business provision	86,900	81,749
	Claims outstanding	450	465
8	Equalisation provision	1	1
	Unearned revenue provision	43	44
	Total technical provisions	<hr/> 87,410 <hr/>	<hr/> 82,277 <hr/>
	Technical provisions for linked liabilities	12,545	10,523
	Provisions for other risks and charges		
7	Deferred taxation	640	350
	Other	13	5
		<hr/> 653 <hr/>	<hr/> 355 <hr/>
	Creditors		
	Creditors arising out of direct insurance operations	77	69
	Creditors arising out of reinsurance operations	52	49
	Amounts owed to credit institutions	45	61
	Other borrowings not owed to credit institutions	359	-
27	Other creditors including taxation and social security	3,733	5,004
28	Preference shares	1	1
		<hr/> 4,267 <hr/>	<hr/> 5,184 <hr/>
	Accruals and deferred income	111	111
	Total liabilities	<hr/> 119,015 <hr/>	<hr/> 110,378 <hr/>

The accounts on pages 14 to 70 were approved by the Board of directors on 26 March 2010.



A.M. Crossley
Director

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements

1. Accounting Policies

A. Basis of Preparation

The financial statements are prepared in accordance with Part 15 of the Companies Act 2006 and Schedule 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. 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) 'Cash flow statements' from preparing a cash flow statement. The Company has not presented a capital position statement with supporting disclosures under FRS 27 'Life Assurance' 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 plc group financial statements which provide information on a group basis complying with this requirement.

The directors have a reasonable expectation that the Company will be able to continue in operational existence for the foreseeable future and thus continue to adopt the going concern basis of accounting in preparing the financial statements. This conclusion has been based upon the following: the Company is a subsidiary within the Prudential Group and it, its parent company and the ultimate parent company are continuing to trade and there are no plans for liquidation, the Company has a healthy solvency margin, well in excess of the Minimum Capital Requirement (MCR) and Enhanced Capital Requirement (ECR) (Note 34 on page 67), is supported by its inherited estate (Note 32 on page 52), generates positive cashflows and has very low debt-financing. In addition consideration has also been given to the Company's performance, the market in which it operates, its strategy and risks and uncertainties, as set out in the Business Review on pages 2 to 9, the management of financial risk as set out in Note 33, including its exposure to liquidity risk and credit risk.

B. Change in accounting policies

The Company has implemented the following changes in preparing its results for the year ended 31 December 2009. These standards closely reflect the requirements of International Financial Reporting Standards (IFRS) and form part of the continuing convergence of IFRS in the UK.

Amendments to FRS 29 – Improving Disclosures About Financial Instruments

In May 2009 the Accounting Standards Board (ASB) approved the 'Amendments to FRS 29 – Improving Disclosures about Financial Instruments', effective from 1 January 2009, which requires enhanced disclosures about fair value measurements and liquidity risk. The amendments include the introduction of a three-level hierarchy for fair value measurement disclosures and additional disclosures about the relative reliability of fair value measurements. This has been included in Note 33.

Amendments to FRS 8 – Related Party Transactions

The amendments to FRS 8 'Related Party Transactions' became effective for the Company in 2009. The Company is required under the amendment to disclose any transactions with subsidiaries which are not wholly-owned. The Company did not have any disclosable transactions under this amendment.

Additionally, in 2009, the Company also adopted the following new accounting pronouncements for which their adoption has no material impact on the financial statements of the Company:

- Amendment on FRS 26 financial instruments – eligible hedged items
- Amendments to UITF Abstract 42 and FRS 26 – Embedded Derivatives
- Amendments to FRS 20 'Share-based Payment – Vesting Conditions and Cancellations'
- Improvements to Financial Reporting Standards

Notes on the financial statements (continued)

1. Accounting Policies (continued)

C. Long-term Business

The measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts under FRS 26 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 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 contracts. 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.

Under FRS 26, 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, expenses 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.

Under FRS 26, 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, as defined above, are not permitted to be recognised under FRS 26 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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

1. Accounting Policies (continued)

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 31.

The Company applies FRS 27, which impacts the basis of reporting for the with-profits business provisions. FRS 27 is underpinned by the FSA's Peak 2 realistic basis of reporting.

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

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 the Scottish Amicable Insurance Fund (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

Notes on the financial statements (continued)

1. Accounting Policies (continued)

periods as unearned premiums, calculated on a daily basis, so that earned premiums relate to risks carried during the accounting period. A similar treatment is applied to acquisition expenses.

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

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

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

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

E. Reinsurance

In the normal course of business the Company seeks to reduce loss exposure by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers. An asset or liability is recognised in the balance sheet representing premiums due to or payments due from reinsurers and the share of benefits and claims recoverable from reinsurers. The measurement of reinsurance assets is consistent with the measurement of the underlying direct insurance contracts.

F. 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 in entities 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 a permanent diminution in value, which is taken to the non-technical account. Investments in participating interests are carried at fair value.

Under FRS 26, 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 and derivatives which deemed to be held for trading. These investments are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses are disclosed separately in Note 3 on page 29 and Note 17 on pages 43 to 44.
- (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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

1. Accounting Policies (continued)

- valuation technique such as discounted cash flow technique. Further information on valuation techniques is provided in Note 33 (A) on pages 53 to 55.
- (iii) Loans and receivables – these comprise 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 provisions of Schedule 3, paragraph 76 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, 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.

G. Financial Liabilities

Financial liabilities are designated as either fair value through profit and loss, amortised cost or investment contracts with discretionary participation features accounted for under FRS 26 and the ABI SORP.

The Company holds financial liabilities on the following bases:

- (i) Financial liabilities at fair value through profit and loss – these comprise derivatives and investment contracts without discretionary participation features. Derivative liabilities are valued at fair value with all changes thereon being recognised in the profit and loss account. An analysis of net gains/losses are disclosed separately in Note 3 on page 29 and Note 17 on pages 43 and 44. Investment contracts without discretionary participation features are covered in section C above.
- (ii) Financial liabilities that are not valued at fair value through profit and loss and are not investment contracts with discretionary participation features are mainly creditors shown at settlement value. The Company also has some operational borrowings where it has chosen to designate as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of these borrowings.
- (iii) Investment contracts with participation features. The accounting policy is covered in section C above.

H. 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.

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.

I. 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

Notes on the financial statements (continued)

1. Accounting Policies (continued)

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.

J. 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.

K. 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 11. 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. Estimated future cash flows are discounted at a high quality corporate bond rate, adjusted to allow for the difference in duration between the bond index and the pension liabilities where appropriate, to determine its present value. PSPS is the largest defined benefit scheme and accounts for 86% of the underlying scheme 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. The Company's share of pension surplus is recognised to the extent that the Company is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme.

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, gains and losses on settlements and curtailments, less the expected investment return on the scheme assets at the start of the reporting period are recognised in the profit and loss account. To the extent that part or all of the Company's interest in the pension surplus is not recognised as an asset, the unrecognised surplus is initially applied to extinguish any past service costs, losses on settlements or curtailments that would otherwise be included in the profit and loss account. Next, the expected investment return on the scheme assets is restricted so that it does not exceed the total of the current service cost, interest cost and any increase in the recoverable surplus. Any further adjustment for the unrecognised surplus is treated as an actuarial gain or loss.

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 long-term technical account. Prior to the transfer of the shareholder funds share of the deficit of SAPS to Prudential Financial Services Limited, a fellow subsidiary undertaking of the Prudential Group with effect from 1 January 2009 (see Note 11), the actuarial gains and losses in respect of the portion attributed to the shareholder funds were recognised in the statement of total recognised gains and losses. Actuarial gains and losses also include adjustment for unrecognised pension surplus as described above.

L. Intangible Assets

Intangible assets are carried at cost less amortisation and any accumulated impairment losses.

Intangible assets include a licence, which 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.

Intangible assets also include distribution rights which relate to facilitation fees paid in relation to the bancassurance partnership arrangements in Asia for the bank distribution of insurance products for a fixed period of time. The distribution rights amounts are amortised over the term of the distribution contracts.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

1. Accounting Policies (continued)

M. Dividend Policy

Dividends are recognised in the period in which they are declared. Dividends declared after the balance sheet in respect of the prior reporting period are treated as a non-adjusting event.

N. Share-based Payments

The Company offers share award and option plans for certain key employees and a SAYE plan for all UK and certain overseas employees. The Company has both equity-settled plans and cash-settled plans.

Share options and awards granted by the parent company (Prudential plc) are valued using the share price at the date of grant and are accounted for as equity-settled i.e. recognised in equity as a capital contribution from Prudential plc. Share options and awards granted by the Company are valued using the share price at the balance sheet date and are accounted for as cash-settled i.e. as an obligation to transfer the equity instruments of Prudential plc. The compensation costs for all awards and options are recognised in net income over the plans' respective vesting periods.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

2. **Segmental analysis**

(a) **Long-term business**

<u>Premiums and profit</u>	Gross premiums written		Balance on the technical account before tax	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
United Kingdom	4,976	7,371	345	512
Hong Kong	1,003	1,154	57	(2)
France	259	278	1	-
	<u>6,238</u>	<u>8,803</u>	<u>403</u>	<u>510</u>

New business

	Regular premiums		Single premiums	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
United Kingdom	237	236	3,930	6,046
Hong Kong	225	200	92	656
France	-	-	259	278
	<u>462</u>	<u>436</u>	<u>4,281</u>	<u>6,980</u>

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 2009 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

	<u>2009 £m</u>	<u>2008 £m</u>
Gross written premiums:-		
Direct	5,747	6,139
Reinsurance accepted	491	2,664
	<u>6,238</u>	<u>8,803</u>
Analysis of gross direct premiums:-		
Individual business	5,190	5,298
Group contracts	557	841
	<u>5,747</u>	<u>6,139</u>
Regular premiums	2,167	2,008
Single premiums	3,580	4,131
	<u>5,747</u>	<u>6,139</u>
Participating contracts	4,567	4,843
Non-participating contracts	549	553
Linked long-term contracts (excluding investment contracts without discretionary participation features for 2009 and 2008)	631	743
	<u>5,747</u>	<u>6,139</u>
United Kingdom	4,744	4,984
Hong Kong	1,003	1,154
France	-	1
	<u>5,747</u>	<u>6,139</u>

Net reinsurance income (expense)

Net reinsurance income in respect of long-term business for the year ended 31 December 2009 was £2,035m (2008: expense of (£811m)).

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

2. Segmental analysis (continued)

(b) General business

<u>Premiums and underwriting result</u>		<u>Gross premiums written</u>		<u>Underwriting result</u>	
		<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>
Continuing operations	Hong Kong	34	28	1	2
Operations in run-off	United Kingdom	-	-	-	(10)
		<u>34</u>	<u>28</u>	<u>1</u>	<u>(8)</u>

<u>Analysis of technical account</u>	<u>Gross Premiums Written</u>		<u>Gross Premiums Earned</u>		<u>Gross Claims Incurred</u>		<u>Gross Operating Expenses</u>		<u>Reinsurance Balance</u>	
	<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>	<u>2008</u> <u>£m</u>
Motor -other classes	2	2	2	2	2	-	1	1	1	(1)
Marine, aviation and transport	-	-	-	-	-	(2)	-	-	-	-
Fire and other damage	4	4	4	3	2	1	2	2	(2)	-
Other	28	22	28	21	13	21	11	8	(1)	(2)
	<u>34</u>	<u>28</u>	<u>34</u>	<u>26</u>	<u>17</u>	<u>20</u>	<u>14</u>	<u>11</u>	<u>(2)</u>	<u>(3)</u>

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:

	<u>Total profit on other activities</u>		<u>Shareholders' funds</u>	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
United Kingdom	57	22	3,100	2,906
Taiwan	4	4	15	17
Indonesia	28	27	584	312
Other countries	-	-	-	2
	<u>89</u>	<u>53</u>	<u>3,699</u>	<u>3,237</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

3. Investment income

	Long-term business		Non-technical account	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
Income from:				
Group undertakings	385	82	22	77
Other investments				
Land and buildings	564	569	-	-
Listed investments	2,694	3,375	1	3
Unlisted investments	288	287	-	-
Other investments	247	440	56	(19)
	<u>4,178</u>	<u>4,753</u>	<u>79</u>	<u>61</u>
(Losses) gains on loans and receivables	(126)	209	-	-
Gains on the realisation of investments at fair value through profit and loss other than derivatives	2,285	2,433	2	47
Gains (losses) on the realisation of derivatives – see Note 33	650	(4,424)	-	-
Exchange (losses) gains	(177)	602	(4)	12
Fees for policy administration and asset management services arising from unit-linked investment contracts	15	32	-	-
	<u>6,825</u>	<u>3,605</u>	<u>77</u>	<u>120</u>

4. 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 £2,545m (2008: £3,626m).

5. Net operating expenses

	Long-term business		General business	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
Depreciation	3	2	-	-
Acquisition costs	395	332	10	8
Change in deferred acquisition costs	(2)	4	(1)	-
Administrative expenses	424	332	3	3
Amortisation of licence and distribution rights (Note 14)	15	10	-	-
	<u>835</u>	<u>680</u>	<u>12</u>	<u>11</u>

Acquisition costs include commissions in respect of long-term direct insurance business of £266m (2008: £146m) and general direct insurance business of £10m (2008: £8m).

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

6. Investment expenses and charges

	Long-term business		Non-technical account	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
Investment management expenses	268	250	-	-
Interest on bank borrowings	7	38	-	-
	<u>275</u>	<u>288</u>	<u>-</u>	<u>-</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED
Notes on the financial statements (continued)

7. Tax

<u>a) Tax charged (credited)</u>	<u>Long-term funds</u>		<u>Shareholders' Profits</u>	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
Current Tax				
UK corporation tax	510	(21)	13	48
Double tax relief	(15)	(19)	(1)	(9)
Overseas tax	34	56	3	3
Adjustments in respect of prior year	39	(12)	16	-
Total current tax	<u>568</u>	<u>4</u>	<u>31</u>	<u>42</u>
Deferred tax				
Origination and reversal of timing differences	285	(1,430)	1	3
Adjustments in respect of prior year	-	-	-	-
Total deferred tax	<u>285</u>	<u>(1,430)</u>	<u>1</u>	<u>3</u>
Shareholders' attributable tax				
Current			168	70
Deferred			(57)	67
Total shareholders' attributable tax			<u>111</u>	<u>137</u>
Tax allocated to non-technical account	(1)	8	1	(8)
Tax charge (credit) on profit on ordinary activities				
	<u>852</u>	<u>(1,418)</u>	<u>144</u>	<u>174</u>

b) Factors affecting tax charge for the period

	<u>2009 £m</u>	<u>2008 £m</u>
Profit on ordinary activities before tax	493	555
Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 28 per cent (2008: effective rate of 28.5 per cent)	138	158
Permanent differences	(1)	9
Adjustment to current tax in respect of previous periods	13	-
Different tax bases of long-term insurance (current and deferred)	56	(65)
Effect of short term timing differences	5	19
Effect of overseas tax	(2)	(17)
Non-taxable dividend income	(9)	-
Current tax charge for the period	<u>200</u>	<u>104</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

c) Balance Sheet

	Attributable to Long-term funds		Attributable to Shareholders' funds	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
Provision for Deferred Tax				
Accelerated capital allowances	(5)	(7)	-	2
Policy reserves	115	133	-	-
Short term timing differences	(103)	(159)	(3)	(6)
Unrealised gains	707	471	-	-
Deferred acquisition costs	(71)	(84)	-	-
Undiscounted provision for deferred tax liability (deferred tax asset)	<u>643</u>	<u>354</u>	<u>(3)</u>	<u>(4)</u>
Deferred tax liability (deferred tax asset) at start of the period	354	1,760	(4)	(6)
Deferred tax charged (credited) in technical/ non-technical account for the period	<u>289</u>	<u>(1,406)</u>	<u>1</u>	<u>2</u>
Deferred tax liability (deferred tax asset) at end of the period	<u>643</u>	<u>354</u>	<u>(3)</u>	<u>(4)</u>

The deferred tax liability relating to the pension asset attributable to the Company of £5m (2008: £4m) 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 account.

8. 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 3 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 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 (2008: £1m). There has been no movement in the equalisation provision during the year (2008: Nil). However an IBNR (Incurred but not reported) provision has been maintained.

9. Operations in run-off

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

	<u>2009 £m</u>	<u>2008 £m</u>
Claims incurred, net of reinsurance		
Claims paid	(2)	(3)
Change in provision for claims	<u>3</u>	<u>(6)</u>
Total	<u>1</u>	<u>(9)</u>
Net operating expenses	<u>(1)</u>	<u>(1)</u>
Technical result	-	<u>(10)</u>
Investment return	-	<u>10</u>
Operating profit before tax	-	-

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

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, the legislation in force at the time of the arrangement, 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.

10. Acquisition and disposal of subsidiaries and participating interests

There have been no acquisitions or disposals of subsidiaries or participating interests in 2009.

On 31 December 2008 the Company transferred Prudential (Netherlands One) Limited at cost of £5m to Prudential Group Holdings Limited.

On 31 December 2008 the Company transferred Prudential Corporation Limited at cost of £2 to Prudential Group Holdings Limited.

On 14 March 2008 St. Helen's Trust Limited was liquidated for £0.1m. There was no profit or loss in the year of liquidation.

11. Information on staff and pension costs

The average number of persons employed by the Company During the year was:	<u>2009</u>	<u>2008</u>
United Kingdom	19	29
Hong Kong	<u>782</u>	<u>756</u>
	<u>801</u>	<u>785</u>
The costs of employment were:	<u>2009 £m</u>	<u>2008 £m</u>
Wages and salaries	36	32
Social security and pension costs	<u>3</u>	<u>2</u>
	<u>39</u>	<u>34</u>

Defined Benefit Pension Schemes

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 2009, on the FRS 17 'Retirement Benefits' (FRS 17) basis of valuation, the underlying PSPS liabilities account for 86% (2008: 87%) 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 including FRS 17. The FRS 17 disclosures are aligned with IAS 19. In 2008, the Prudential Group adopted IFRIC 14, interpretation guidance to IAS 19 with the effect of derecognising the Prudential Group's interest in PSPS surplus and recognising an additional liability for the deficit funding obligation for PSPS in the Group financial statements.

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

Notes on the financial statements (continued)

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 2008 using the projected unit method. This valuation demonstrated the Scheme to be 106 per cent funded by reference to the Scheme Solvency Target that forms the basis of the Scheme's statutory funding objective. Accordingly, the total contributions to be made by the Group to the Scheme were reduced from the previous arrangement of £70 – £75 million per annum to £50 million per annum effective from 1 July 2009. As PSPS was in a surplus position at the valuation date, no formal recovery plan was required. However, recognising that there had been a significant deterioration in the value of the Scheme's assets from 5 April 2008 to the date of the finalisation of the valuation, contributions to the Scheme for additional funding of £25 million per annum as well as a £25 million per annum employer's contribution for ongoing service of current employees, were agreed with the PSPS Trustees subject to a reassessment when the next valuation is completed. The additional funding is akin to deficit funding. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the Company's with-profits fund and Prudential plc following detailed consideration in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees have been apportioned in the ratio relevant to current activity. In 2009, total contributions for the year, including expenses and augmentations, were £67 million (2008: £79 million).

The valuation of the Scottish Amicable Pension Scheme as at 31 March 2008 demonstrated the scheme to be 91 per cent funded, with a shortfall of actuarially determined liabilities of 9 per cent, representing a deficit of £38 million. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a seven year period were made from July 2009 of £7.3 million per annum.

For SAPS, it is estimated that 50% of the FRS 17 deficit is attributable to the Company's with-profits sub-fund. Prior to 2009, the other 50% is attributable to the Company's shareholders' funds and recognised in the Company's financial statements. In 2009, following a reassessment, the shareholders' share of the deficit of SAPS was transferred to be borne by Prudential Financial Services Limited, a fellow subsidiary undertaking of the Prudential Group with effect from 1 January 2009.

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, consideration is given to the nature and duration of the scheme's liabilities. The Trustee sets the benchmark for the asset mix, following analysis of the liabilities by the Scheme's Actuary and, having taken advice from the Investment Managers, then selects benchmark indices for each asset type in order to measure investment performance against a benchmark return.

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

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

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

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

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

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

	2009	2008
	%	%
Price inflation	3.7	3.0
Rate of increase in salaries	5.7	5.0
Rate of increase of pensions in payments:		
PSPS		
Guaranteed - LPI (Max 5%)	3.7	3.0
Guaranteed - LPI (Max 2.5%)	2.5	2.5
Discretionary	2.5	2.5
SAPS	3.7	3.0
Rate used to discount scheme liabilities	5.8	6.1

Long-term expected rates of return	Prospectively for 2010	2009	2008
	%	%	%
Equities	8.50	6.80	7.50
Bonds	5.30	4.80	5.40
Properties	6.75	6.05	6.75
Other assets	4.75	2.00	5.50
Weighted average long-term expected rate of return	5.90	4.50	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 based on adjusted versions of the medium cohort projections prepared by the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries.

The tables used for PSPS immediate annuities in payment at 31 December 2009 were:

Male: 108.6 per cent PNMA 00 with medium cohort improvements subject to a floor of 1.75 per cent up to the age of 90, decreasing linearly to zero by age of 120; and
Female: 103.4 per cent PNFA 00 with 75 per cent medium cohort improvements subject to a floor of 1.00 per cent up to the age of 90 and decreasing linearly to zero by age of 120.

The tables used for PSPS immediate annuities in payment at 31 December 2008 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:

	2009		2008	
	Years		Male	Female
Retiring today	27.4	28.6	26.4	28.4
Retiring in 15 years time	30.1	30.8	28.9	29.8

The mean term of the current PSPS liabilities is around 18 years.

Using external actuarial advice provided by the professionally qualified actuaries, Towers Watson (previously known as Watson Wyatt Partners), for the valuation of PSPS and Xafinity for SAPS, the most recent full valuations have been updated to 31 December 2009 applying the principles prescribed by FRS 17.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The assets and liabilities of PSPS and SAPS were:

	31 Dec 09		31 Dec 08		31 Dec 07	
	£m	%	£m	%	£m	%
Equities	1,018	19	978	19	1,472	28
Bonds	3,587	68	2,619	51	1,299	25
Properties	278	5	290	6	583	11
Other assets	442	8	1,270	24	1,935	36
Total value of assets	5,325	100	5,157	100	5,289	100
Present value of underlying scheme liabilities	4,951		4,473		4,815	
Underlying surplus (deficit) in the schemes	374		684		474	

Of which the following amounts have been attributed to the Company:

Attributable to the Company's with-profits fund	51	98	338
Attributable to the Company's shareholders' funds*	-	(22)	(27)
	<u>51</u>	<u>76</u>	<u>311</u>

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

	2009 £m	2008 £m	2007 £m
With-profits fund	46	88	304
Shareholders' funds*	-	(16)	(20)
	<u>46</u>	<u>72</u>	<u>284</u>

* The shareholders' share of the deficit of SAPS previously borne by the Company's shareholders' funds was transferred to Prudential Financial Services Limited, a fellow subsidiary undertaking of the Prudential Group from 2009.

The surplus in the Prudential Staff Pension Scheme recognised in the balance sheet of the Company represents the element of the amount which is recoverable through reduced future contributions that is attributable to the Company and is net of the apportionment to Prudential plc.

Underlying scheme assets and liabilities of PSPS and SAPS

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:

	2009 £m	2008 £m
Present value of scheme liabilities at beginning of year	4,473	4,815
Service costs – current	30	38
Interest cost	266	277
Curtailment credit	-	(44)
Employee contributions	2	1
Actuarial losses (gains)	412	(398)
Benefit payments	(232)	(216)
Present value of scheme liabilities at end of year	<u>4,951</u>	<u>4,473</u>

	2009 £m	2008 £m
Fair value of scheme assets at beginning of year	5,157	5,289
Expected return on scheme assets	232	324
Employee contributions	2	1
Employer contributions*	76	85
Actuarial gains (losses)	90	(326)
Benefit payments	(232)	(216)
Fair value of scheme assets at end of year	<u>5,325</u>	<u>5,157</u>

* The contributions include deficit funding, ongoing service contributions, expenses and augmentations.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

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

	2009 £m	2008 £m
Pension (charge) credit		
Operating charge – current service cost	(30)	(38)
Curtailment credit	-	44
Finance income (expense):		
Interest on pension scheme liabilities	(266)	(277)
Expected return on pension scheme assets**	232	324
	(34)	47
Total pension (charge) credit of the schemes	(64)	53
Of which the following amounts have been attributed to the Company:		
With-profits fund	(33)	0
Shareholders' funds	-	0
	(33)	0

The pension (charge) credit relating to PSPS attributable to the Company is related to the surplus recognised on the balance sheet of the Company. In 2008, an amount of £48m was applied from the unrecognised portion of the PSPS surplus as at 31 December 2008 to extinguish the pension credit attributable to the Company. There was no such amount applied against the pension charge in 2009.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Actuarial (losses) gains					
Actual less expected return on scheme assets * (2%, (6%), 0%, 3%, 11% of pension scheme assets)	91	(325)	(3)	150	533
Experience gains (losses) on scheme liabilities (1%, 3%, 0%, 0%, 0% of the present value of scheme liabilities)**	62	148	(14)	18	(1)
Changes in assumptions underlying the present value of scheme liabilities	(475)	250	307	254	(453)
Total actuarial (losses) gains of the schemes ((7%), 2%, 6%, 8%, 2% of the present value of the scheme liabilities)	(322)	73	290	422	79
Of which the following amounts have been attributed to the Company:					
With-profits fund	(55)	(287)	205	288	118
Shareholders' funds	-	2	(6)	16	(8)
	(55)	(285)	199	304	110

* The total actual return on scheme assets for both PSPS and SAPS is a net gain of £323m (2008: net loss of £2m) of which a net gain of £207m (2008: net gain of £6m) relates to the amounts attributable to the Company's with-profits funds.

** The experience gains on scheme liabilities in 2008 of a gain of £148m related mainly to the 'true-up' reflecting improvements in data consequent upon the ongoing triennial valuation of PSPS.

The actuarial (losses) gains relating to PSPS attributable to the Company's with-profits fund are related to the surplus (deficit) recognised on the balance sheet of the Company. In 2009, the actuarial (losses) gains attributable to the Company's with-profits fund included a loss of £152m (2008: £337m) for the unrecognised portion of the PSPS surplus which has not been deducted from pension credit (charge). Since the shareholders' profit in respect of the Company's with-profits fund is a function of the actuarially determined surplus for distribution, the overall profit and loss account result is not directly affected by the level of pension cost or other expenses relating to the with-profits fund. The amounts of pension charge of £33m (2008: credit of £Nil) and actuarial losses of £55m (2008: actuarial losses of £287m) 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 2005 actuarial gains attributable to the Company's with-profits fund included an additional gain of £59m in 2005 reflecting 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 PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

The pension charge in 2008 of £Nil attributable to the Company's shareholders' funds are included in the non-technical account. The actuarial gains before tax attributable to the Company's shareholders' funds of £2m in 2008 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 2008 for the Company amounted to £2m gains. As explained above, from 2009, the shareholders' share of the FRS 17 deficit of SAPS was transferred to be borne by a fellow subsidiary of the Prudential Group. Accordingly, no further pension charges and actuarial gains and losses attributable to the Company's shareholders' funds are recognised in the Company's financial statements.

Total employer contributions expected to be paid into PSPS and SAPS for the year ending 31 December 2010 amounts to £67m, reflecting the new funding arrangement agreed in 2009, following the completion of the 2008 actuarial valuation, and expenses.

The table below shows the sensitivity of the underlying PSPS and SAPS liabilities at 31 December 2009 of £4,436m (2008: £4,075m) and £515m (2008: £398m) to changes in discount rates and inflation rates.

Assumption	Change in assumption	Impact on PSPS and SAPS scheme liabilities on FRS17 basis
2009		
Discount rate	Decrease by 0.2% from 5.8% to 5.6%	Increase scheme liabilities by: PSPS 3.5% SAPS 5.2%
Discount rate	Increase by 0.2% from 5.8% to 6.0%	Decrease scheme liabilities by: PSPS 3.2% SAPS 4.8%
Rate of inflation	Decrease by 0.2% from 3.7% to 3.5% with consequent reduction in salary increases	Decrease scheme liabilities by: PSPS 0.9% SAPS 4.9%
2008		
Discount rate	Decrease by 0.2% from 6.1% to 5.9%	Increase scheme liabilities by: PSPS 3.3% SAPS 4.9%
Discount rate	Increase by 0.2% from 6.1% to 6.3%	Decrease scheme liabilities by: PSPS 3.1% SAPS 4.6%
Rate of inflation	Decrease by 0.2% from 3.0% to 2.8% with consequent reduction in salary increases	Decrease scheme liabilities by: PSPS 0.8% SAPS 4.5%

The sensitivity of the underlying pension scheme liabilities to changes in discount rates and inflation rates as shown above does not directly equate to an impact on shareholders' profit or shareholders' funds due to the allocation of a share of the interest in financial position of the PSPS and SAPS to the Company's with-profits fund as described above.

The amounts attributable to the Company's with-profits fund for both PSPS and SAPS are absorbed by the transfer to or from the fund for future appropriations and therefore have no direct effect on shareholders' profit or shareholders' funds.

Defined Contribution Pension Schemes

The Company operates defined contribution schemes in Hong Kong. The cost of these contributions was £1.7m (2008: £1.2m). £1.2m was outstanding at 31 December 2009 (2008: £1.1m).

Notes on the financial statements (continued)

Share-based payments

Employees of the Company participate 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. Beginning 2010, newly issued shares will be used in settling the awards that vest and are released.

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 Business Unit Performance Plan (BUPP) is an incentive plan created to provide a common framework under which awards would be made to senior employees. Awards under this plan are based on growth in Shareholder Capital Value on the European Embedded Value (EEV) basis with performance measured over three years. Upon vesting of awards made up to 2008, 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 directors 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. In 2009, the rules governing the SAYE scheme were amended so that savings contracts for seven years were discontinued and employees may save up to £250 per month for three or five 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.

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Notes on the financial statements (continued)

The Prudential Corporation Asia Long-Term Incentive Plan (PCA LTIP) is an incentive plan created in 2008 for senior employees and Chief Executive Officers to replace the Asia Business Unit Performance Plan (BUPP). The Company has a branch in Hong Kong and is therefore eligible to participate. Awards under the new PCA LTIP will vest after three years subject to the employee being in employment at the time of vesting without any performance conditions. Awards will be discretionary and on a year by year basis determined by Prudential's full year financial results and the employee's contribution to the business. All awards will be in Prudential shares.

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

Movements in share options outstanding under the Company's share-based compensation plans relating to Prudential plc shares during 2009 and 2008 were as follows:

	2009		2008	
	Number of options	Weighted average exercise price £	Number of options	Weighted average exercise price £
Options outstanding (including conditional options)				
Beginning of year:	505,941	1.87	518,096	1.98
Granted	251,094	2.66	171,562	4.44
Exercised	(134,895)	0.03	(57,851)	3.31
Forfeited	(26,230)	2.23	(27,622)	3.92
Expired	(301,105)	5.18	(98,244)	5.18
End of year	294,805	2.45	505,941	1.87
Options immediately exercisable, end of year	1,547	5.65	9,547	4.07

The weighted average share price of Prudential plc for the year ended 31 December 2009 was £4.17 compared to £5.46 for the year ended 31 December 2008.

Movements in share awards outstanding under the Group's share-based compensation plans relating to Prudential plc shares at 31 December 2009 and 2008 were as follows:

	2009	2008
	Number of awards	Number of awards
Awards outstanding		
Beginning of year:	211,309	164,987
Granted	392,496	111,003
Exercised	(42,327)	(53,233)
Forfeited	(92,345)	(10,427)
Expired	(20,851)	(1,021)
End of year	448,282	211,309

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2009.

Range of exercise prices	Number outstanding	Outstanding Weighted average remaining contractual life (years)	Weighted average exercise prices £	Exercisable	
				Number exercisable	Weighted average exercise prices £
Between £0 and £1	66,942	8.14	0.00	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	195,813	3.45	2.88	-	-
Between £3 and £4	-	-	-	-	-
Between £4 and £5	15,952	3.13	4.28	-	-
Between £5 and £6	16,098	1.34	5.55	1,547	5.65
Between £6 and £7	-	-	-	-	-
	294,805	4.38	2.45	1,547	5.65

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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 2008.

Range of exercise prices	Number outstanding	Outstanding Weighted average remaining contractual life (years)	Weighted average exercise prices	Exercisable	
				Number exercisable	Weighted average exercise prices
Between £0 and £1	304,870	7.80	£ 0.0	-	-
Between £1 and £2	-	-	-	-	-
Between £2 and £3	-	-	-	-	-
Between £3 and £4	-	-	-	-	-
Between £4 and £5	152,134	2.96	4.43	9,547	4.07
Between £5 and £6	48,937	2.29	5.56	-	-
Between £6 and £7	-	-	-	-	-
	505,941	5.81	1.87	9,547	4.07

The years shown above for weighted average remaining contractual life include the time period from end of vesting period to expiration of contract.

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

GPSP	2009			2008		
	Weighted average fair value			Weighted average fair value		
	Other options	Awards		GPSP	Other options	Awards
£	£	£	£	£	£	£
5.60	1.55	5.79	2.67	2.09	3.86	

The fair value amounts relating to all options including conditional nil cost options were determined using the Black-Scholes and the Monte Carlo option-pricing models using the following assumptions:

	2009		2008	
	GPSP	Other options	GPSP	Other options
Dividend yield (%)	4.41	4.41	3.60	3.60
Expected volatility (%)	37.58	60.66	30.65	35.64
Risk-free interest rate (%)	1.77	2.17	4.18	4.43
Expected option life (years)	3.00	3.61	3.00	3.22
Weighted average exercise price (£)	-	2.97	-	4.67
Weighted average share price (£)	6.40	3.82	4.17	6.09

Compensation costs for all share-based compensation plans are determined using the Black-Scholes model and the Monte Carlo model. Share options and awards granted by the parent company are valued using the share price at the date of grant. Share options and awards granted by the Company are valued using the share price at the balance sheet date. 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 and awards other than GPSP, for which the Monte Carlo model is used in order to allow for the impact of the TSR performance conditions. The models are used to calculate fair values at the grant date or balance sheet date, as appropriate, based on the quoted market price of the stock at the measurement date, 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.

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Notes on the financial statements (continued)

When options are granted or awards made to employees, an estimate is made of what percentage is more than likely to vest, be forfeited, lapse or cancelled based on historical information. Based on these estimates, compensation expense to be accrued at that date is calculated and amortised over the vesting period. For early exercises of options or release of awards due to redundancy, death or resignation, the compensation expense is immediately recognised and for forfeitures due to employees leaving the Group, any previously recognised expense is reversed. However, if an employee loses their award because of the Group's failure to meet the performance criteria, previously recognised expense is not reversed.

The total share-based payment expense recognised in the non-technical account for 2009 is £0.4m (2008: £1.2m) of which £0.3m (2008: £0.2m) is accounted for as equity-settled and £0.1m (2008: £1.0) is accounted for as cash-settled.

12. Directors' emoluments

	2009	2008
	£	£
Aggregate emoluments	2,392,645	2,628,050
Aggregate amounts receivable (excluding shares) under long term incentive schemes	-	1,959,779
Excess retirement benefits:		
Current directors	87,819	140,231
Past directors	-	21,660
Other cash payments (note i)	448,075	-
	<u>2,928,539</u>	<u>4,749,720</u>
Highest Paid Director:		
Aggregate emoluments and amounts receivable (excluding shares) under long term incentive schemes	<u>1,086,574</u>	<u>1,118,198</u>

Note i: Mr Nick Prettejohn resigned from the Company and the Prudential Group on 30 September 2009. The remuneration arrangements on leaving that were approved by the Remuneration Committee of the Prudential Group include a payment equivalent to nine months salary and benefits, paid in instalments in October 2009 and January 2010 relating to restrictions on employment up to 1 April 2010.

No directors (2008: three) exercised share options during the year. Seven directors (2008: seven) were entitled to shares under Prudential's main long-term incentive scheme and two directors (2008: four) were entitled to retirement funds under defined benefit schemes. The highest paid director did not exercise any share options but did receive shares under long-term incentive schemes. The highest paid director in 2008 did not exercise any share options and did not receive any shares under long-term incentive schemes.

13. Auditors' remuneration

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

	<u>2009 £m</u>	<u>2008 £m</u>
Audit services		
Fees payable to KPMG for the audit of the Company's accounts	2.0	1.9
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	0.7	0.7
	<u>2.7</u>	<u>2.6</u>

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Notes on the financial statements (continued)

14. Intangible assets

	Distribution Rights £m	Licence £m	Total £m
Cost:			
At 1 January 2009	148	174	322
Exchange differences	(16)	-	(16)
Additions	-	-	-
Disposals	-	-	-
At 31 December 2009	<u>132</u>	<u>174</u>	<u>306</u>
Amortisation:			
At 1 January 2009	1	60	61
Exchange differences	-	-	-
Provided in the year in the long-term business technical account	5	10	15
Disposals	-	-	-
At 31 December 2009	<u>6</u>	<u>70</u>	<u>76</u>
Net book value at 31 December 2009	<u>126</u>	<u>104</u>	<u>230</u>
Net book value at 31 December 2008	147	114	261

The charge for amortisation for the year ended 31 December 2008 was £10m charged to the long-term business technical account.

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 distribution rights relate to facilitation fees paid in relation to the bancassurance partnership arrangements in Asia for the bank distribution of insurance products for a fixed period of time. The distribution rights amounts are amortised over the term of the distribution contracts.

There have been no impairments during the year (2008: £Nil).

15. Land and buildings

	<u>2009 £m</u>	<u>2008 £m</u>
Current value		
Freeholds	3,855	4,120
Leaseholds with a term of over 50 years	1,113	2,075
Leaseholds with a term of less than 50 years	984	322
	<u>5,952</u>	<u>6,517</u>
Cost	<u>4,843</u>	<u>5,063</u>

The value of land and buildings occupied by the Company amounted to £79m (2008: £86m)

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

Freehold and leasehold land and buildings

	<u>2009 £m</u>	<u>2008 £m</u>
At cost	4,843	5,063
Aggregate depreciation	(909)	(1,196)
Net book value based on historical cost	<u>3,934</u>	<u>3,867</u>

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

16. Investments in group undertakings and participating interests

	Cost		Current value	
	2009 £m	2008 £m	2009 £m	2008 £m
Shares in group undertakings				
Long-term fund investments	1,566	1,633	3,189	3,530
Shareholder investments	1,227	1,195	2,294	1,870
	<u>2,793</u>	<u>2,828</u>	<u>5,483</u>	<u>5,400</u>
Loans to group undertakings				
Long-term fund loans	760	716	760	716
Total	<u>3,553</u>	<u>3,544</u>	<u>6,243</u>	<u>6,116</u>

The principal subsidiary undertakings of the Company at 31 December 2009, all wholly owned, with the exception of PT Prudential Life Assurance :

	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
PT Prudential Life Assurance	Ordinary shares Rupiah 1m 94.6% holding	Insurance	Indonesia
* Owned by the long-term fund.			

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

17. Other financial investments

	Cost		Carrying value	
	2009 £m	2008 £m	2009 £m	2008 £m
Shares and other variable yield securities and Units in unit trusts	23,644	31,128	31,510	34,765
Debt securities and other fixed income securities	31,382	28,353	32,809	28,248
Derivative assets	126	32	687	796
Loans secured by mortgages	679	490	679	490
Loans to policyholders secured by insurance policies	74	77	74	77
Other loans	930	1,158	930	1,158
Deposits with credit institutions	10,080	5,222	10,080	5,222
	<u>66,915</u>	<u>66,460</u>	<u>76,769</u>	<u>70,756</u>

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Notes on the financial statements (continued)

The change in carrying value of other financial investments included in the Profit and Loss account was a gain of £5,604m (2008: £16,875m loss) analysed between a gain of £5,609m (2008: £16,811m loss) included in the Long-term business technical account and a loss of £5m (2008: £64m loss) included in the Non-technical account. The change in carrying value of £5,604m (2008: £16,875m) included a gain of £4,293m (2008: £16,829m loss) in respect of equity securities, a gain of £1,557m (2008: £42m gain) in respect of debt securities, a loss of £16m (2008: £11m gain) in respect of derivatives and a loss of £230m (2008: £99m loss) in respect of other financial instruments.

Amounts included in the above relating to listed investments:	Carrying value	
	<u>2009 £m</u>	<u>2008 £m</u>
Shares and other variable yield securities and units in unit trusts	23,585	27,607
Debt securities and other fixed income securities	30,360	25,567
	<u>53,945</u>	<u>53,174</u>

The table below analyses the derivative positions of the Company.

	<u>2009 £m</u>		<u>2008 £m</u>	
	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	240	77	271	73
Cross currency swaps	-	15	-	32
Inflation swaps	1	2		
Currency exchange forward contracts	339	297	265	2,334
Interest rate swaptions	55	1	67	-
Bond futures	38	33	36	163
Credit Default Swaps	2	1	1	18
Derivative financial instruments held to manage market risk and efficient investment management:				
Equity options	4	-	4	2
Equity futures	7	20	36	4
Total return swaps	1	9	116	51
Total	<u>687</u>	<u>455</u>	<u>796</u>	<u>2,677</u>

The nature and extent of the derivative financial instruments used by the Company in 2009 are similar to those used in 2008 and their use and notional amounts are disclosed in note 33.

18. Assets held to cover linked liabilities

	Cost		Current value	
	<u>2009 £m</u>	<u>2008 £m</u>	<u>2009 £m</u>	<u>2008 £m</u>
Assets held to cover linked liabilities (net of reinsurance)	6,764	6,570	7,648	6,538

19. 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.

20. Other debtors

	<u>2009 £m</u>	<u>2008 £m</u>
Amounts owed by fellow subsidiaries and holding company	536	486
Amounts owed by subsidiary companies	420	411
Tax recoverable	59	302
Other	100	134
	<u>1,115</u>	<u>1,333</u>

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Notes on the financial statements (continued)

21. Tangible fixed assets

	Computer Equipment £m	Fixtures & Fittings £m	Total £m
Cost:			
At 1 January 2009	40	80	120
Exchange differences	(1)	(2)	(3)
Additions	1	1	2
Disposals	-	-	-
At 31 December 2009	<u>40</u>	<u>79</u>	<u>119</u>
Depreciation:			
At 1 January 2009	39	73	112
Exchange differences	(1)	(2)	(3)
Provided in the year	1	2	3
Disposals	-	-	-
At 31 December 2009	<u>39</u>	<u>73</u>	<u>112</u>
Net book value at 31 December 2009	<u>1</u>	<u>6</u>	<u>7</u>
Net book value at 31 December 2008	<u>1</u>	<u>7</u>	<u>8</u>

The charge for depreciation for the year ended 31 December 2008 was £3m.

22. Assets attributable to the long-term business fund

Of the total amount of assets shown in the balance sheet on page 18, £115,063m (2008: £107,273m) is attributable to the long-term business fund.

23. Share capital

The Company's issued share capital is £330,517,064 comprising 970,468,254 ordinary shares of 25p each fully paid, 1,000,000 A Preference Shares of £1 each fully paid, and 347,600,000 B Preference Shares of 25p each fully paid. No changes in the share capital of the Company took place during the year.

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

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Notes on the financial statements (continued)

24. Shareholders' reserves

	Revaluation reserve	Other reserves	Profit and loss account	Total
	£m	£m	£m	£m
Balance at 1 January 2009	558	536	1,813	2,907
Exchange adjustments	-	-	(8)	(8)
Revaluation of subsidiaries	389	-	-	389
Profit for the financial year	-	-	349	349
Dividends	-	-	(284)	(284)
Other movements – transfer of Scottish Amicable Pension Scheme (SAPS) deficit from the Company to another Group Company	-	-	16	16
Balance at 31 December 2009	<u>947</u>	<u>536</u>	<u>1,886</u>	<u>3,369</u>

	<u>2009 £m</u>	<u>2008 £m</u>
Analysis of profit and loss account:		
Distributable retained profit	1,481	1,430
Undistributable retained profit	405	383
	<u>1,886</u>	<u>1,813</u>

25. Fund for future appropriations

	<u>2009 £m</u>	<u>2008 £m</u>
Prudential Assurance Company with-profits fund (excluding SAIF)	<u>10,330</u>	<u>8,691</u>

26. 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.

27. Other creditors including taxation and social security

	<u>2009 £m</u>	<u>2008 £m</u>
Amounts owed to fellow subsidiaries and holding company	150	135
Amounts owed to subsidiary companies	1,067	641
Tax	356	15
Derivative liability (see note 17)	455	2,677
Other creditors	<u>1,705</u>	<u>1,536</u>
	<u>3,733</u>	<u>5,004</u>

28. Preference shares

	<u>2009 £m</u>	<u>2008 £m</u>
A preference shares of £1 each – see Note 23	1	1

29. 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.

Notes on the financial statements (continued)

30. Related party transactions

The Company has taken advantage of the exemption under paragraph 3(c) of FRS 8 'Related party disclosures' from disclosing transactions with other wholly-owned subsidiary undertakings of the Prudential Group.

During 2009, in respect of the Company's joint venture (Prudential Health Holdings Limited), a £14m (2008: £7m) capital injection was made. £11m (2008: £12m) was recharged to the Company from Prudential Health Services Limited for services provided in respect of the PruProtect product underwritten by the Company. An agreement was entered into on 3 September 2007 which allows the Company to borrow from Prudential Health Holdings Limited up to an aggregate amount of £250m. The loan amount is principally linked to the emergence of regulatory losses arising in respect of all income and costs associated with selling and underwriting the Flexible Protection Plan and PruProtect Plan. The loan is to be repaid as regulatory surpluses arise in the future. In 2009 the Company borrowed £19m (2008: £17m) under this arrangement.

31. 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 2009 year end Investment Return for asset shares is:

Return	With-Profits Sub Fund	High Reversionary Bonus fund	SAIF
Gross return	18.75%	19.88%	18.19%
Net return	15.68%	16.60%	15.14%

The High Reversionary Bonus fund is contained within the With-Profits Sub-Fund. Compared with the assets backing the main asset share fund, the High Reversionary Bonus fund holds a higher proportion of fixed interest securities and a lower proportion of equities.

Prospective assumptions

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

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

Expense assumptions have been taken as the level of expenses incurred during 2009.

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Notes on the financial statements (continued)

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 2009 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 for most products are based on those used for European Embedded Value calculations. The exceptions are Prudence Bond, PSA/PIB and Industrial Branch whole life policies for which the persistency assumptions, before the adjustment described below, are respectively 80%, 90% and 40% of 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.

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:

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Notes on the financial statements (continued)

- (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.
- (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 following discount and mortality bases were used:

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

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

Linked business in the Non-Profit Sub-Fund

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

Discount Rate	4.00% gross
Fund Growth	5.75% gross
Mortality	AM/AF92+1 plus 1/3 AIDS "R6A" for most contracts
Administration Expenses	£25 to £98 p.a. depending on the product type
Expense Inflation	4.25% p.a.

Compared with the 2008 valuation the assumptions regarding administration expenses have been revised to allow for actual and forecast costs.

Linked business in the With-Profit Sub-Fund

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

Discount Rate	4.00% gross
Fund Growth	5.75% gross
Mortality	AM/AF92 -3 years
Administration Expenses	£26 to £150 p.a. depending on the product type
Expense Inflation	4.25% p.a.

Compared with the 2008 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

Notes on the financial statements (continued)

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.

32. 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 either has an obligation, or it is probable that it 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 2009.

	Year ended 31 December 2009 £m	Year ended 31 December 2008 £m
Balance at start of the period	345	448
Changes to actuarial assumptions and method of calculation	20	(75)
Discount unwind	3	20
Redress to policyholders	(44)	(46)
Payment of administrative costs	(2)	(2)
Balance at end of the period	322	345

The Financial Ombudsman Service periodically updates the actuarial assumptions to be used in calculating the compensation payments, 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.

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Notes on the financial statements (continued)

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.

During 2009, the FSA issued a policy statement confirming that certain payments of compensation and redress for events occurring after 31 July 2009 may only be paid from assets attributable to shareholders. As the pensions mis-selling review was concluded prior to this date, the requirements of the policy statement do not impact the provisions outlined above.

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). Technical provisions of £4m in the non-profit sub-fund and £35m in SAIF were held at 31 December 2009 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 £2m in respect of mortgage endowment products mis-selling claims in the year ended 31 December 2009 and held a technical provision of £47m at 31 December 2009, 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 technical provision of £31m at 31 December 2009, 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 technical provision of £284m was held in SAIF at 31 December 2009, 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.

Notes on the financial statements (continued)

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 with-profits sub-fund (WPSF) within the long-term 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 WPSF 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 WPSF is called the 'inherited estate' and has accumulated over many years from various sources.

The inherited estate, as working capital, 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.

Support of Long-term Business Funds by Shareholders' Funds

As a proprietary insurance company, the Company is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets, represented by the unallocated surplus of with-profits funds, in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers ('the excess assets') in the long-term funds could be materially depleted over time by, for example, a significant or sustained equity market downturn, costs of significant fundamental strategic change or a material increase in the pension mis-selling provision. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Company's ability to satisfy policyholders' reasonable expectations was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

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 unutilised 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 2009 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.

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Notes on the financial statements (continued)

33. 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 FRS 26 and the ABI SORP as described in the Accounting Policies section.

2009	Fair value through profit and loss £m	Loans and receivables £m		Total carrying value £m	Fair value £m
Financial Assets					
Deposits with credit institutions	-	10,080		10,080	10,080
Equity securities and portfolio holdings in unit trusts	29,660	-		29,660	29,660
Debt securities and other fixed income securities (note i)	32,809	-		32,809	32,809
Loans (note ii)	-	1,683		1,683	1,604
Other investments (note iii)	1,850	-		1,850	1,850
Derivative assets	687	-		687	687
Accrued investment income	-	766		766	766
Other debtors	-	1,056		1,056	1,056
Cash at bank and in hand	-	856		856	856
Total	65,006	14,441		79,447	79,368
	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	-	45	-	45	45
Other borrowings not owed to credit institutions (note iv)	-	359	-	359	359
Investment contracts with discretionary participation features (note v)	-	-	24,815	24,815	-
Investment contracts without discretionary participation features	5,829	-	-	5,829	5,829
Creditors arising out of direct insurance operations	-	77	-	77	77
Creditors arising out of reinsurance operations	-	52	-	52	52
Other creditors	-	2,922	-	2,922	2,922
Derivative liabilities	455	-	-	455	455
Total (note v)	6,284	3,455	24,815	34,554	9,739

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Notes on the financial statements (continued)

2008	Fair value through profit and loss £m	Loans and receivables £m		Total carrying value £m	Fair value £m
Financial Assets					
Deposits with credit institutions	-	5,222		5,222	5,222
Equity securities and portfolio holdings in unit trusts	32,782	-		32,782	32,782
Debt securities and other fixed income securities (note i)	28,248	-		28,248	28,248
Loans (note ii)	-	1,725		1,725	1,459
Other investments (note iii)	1,983	-		1,983	1,983
Derivative assets	796	-		796	796
Accrued investment income	-	803		803	803
Other debtors	-	1,031		1,031	1,031
Cash at bank and in hand	-	995		995	995
Total	63,809	9,776		73,585	73,319
	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	-	61	-	61	61
Other borrowings not owed to credit institutions (note iv)	-	-	-	-	-
Investment contracts with discretionary participation features (note v)	-	-	27,790	27,790	-
Investment contracts without discretionary participation features	3,983	-	-	3,983	3,983
Creditors arising out of direct insurance operations	-	69	-	69	69
Creditors arising out of reinsurance operations	-	49	-	49	49
Other creditors	-	2,312	-	2,312	2,312
Derivative liabilities	2,677	-	-	2,677	2,677
Total (note v)	6,660	2,491	27,790	36,941	9,151

Notes

- (i) As at 31 December 2009, £648m (2008: £457m) of convertible bonds were included in debt securities. There were no convertible bonds included in borrowings.
- (ii) Loans and receivables are reported net of allowance for loan losses of £38m (2008: £28m).
- (iii) Other investments include participation in various investment funds and limited liability property partnerships.
- (iv) As at 31 December 2009, £359m of loan repayable, contingent on regulatory surplus emerging, was included in "Other borrowings not owed to credit institutions".
- (v) 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.
- (vi) For financial liabilities designated as fair value through profit and loss there was no material impact on profit from movements in credit risk during 2009 and 2008.

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 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 or by using appropriate valuation techniques. Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques 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. When determining the inputs

Notes on the financial statements (continued)

into the valuation techniques used priority is given to publicly available prices from independent sources, when available but overall, the source of pricing is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date.

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

The loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The rate of discount used was the market rate of interest.

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

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

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

Level 1, 2 and 3 fair value measurement hierarchy of financial instruments

In May 2009 FRS 29 'Financial Instruments: Disclosures' was amended by the ASB to require certain additional disclosures to be included in the financial statements. This includes, as is presented below, a table of financial instruments carried at fair value analysed by level of the FRS29 defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement. FRS29 does not require comparatives to be provided in the year of adoption.

The classification criteria and its application to the Company can be summarised as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets and liabilities

Level 1 principally includes exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and national government bonds unless there is evidence that trading in a given instrument is so infrequent that the market could not possibly be considered active. It also includes other financial instruments where there is clear evidence that the year end valuation is based on a traded price in an active market.

Level 2 – inputs other than quoted prices included within level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 2 principally includes corporate bonds and other non-national government debt securities which are valued using observable inputs, together with over-the-counter derivatives such as forward exchange contracts and non-quoted investment funds valued with observable inputs. It also includes investment contract liabilities that are valued using observable inputs.

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £28,068m, £1,414m are valued internally. The majority of such securities use matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring a specified liquidity premium. The significance of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

THE PRUDENTIAL ASSURANCE COMPANY LIMITED

Notes on the financial statements (continued)

Level 3: Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs)

Level 3 principally includes investments in private equity funds, investments in property funds which are exposed to bespoke properties or risks and investments which are internally valued or subject to a significant number of unobservable assumptions. It also includes debt securities which are rarely traded or traded only in privately negotiated transactions and hence where it is difficult to assert that these have been based on observable market data. The inherent nature of the vast majority of these assets means that, in normal market conditions, there is unlikely to be significant change in the specific underlying assets classified as level 3.

At 31 December 2009 the Company held £2,070m, 3% of the fair valued financial instruments, within level 3. Of these amounts £2,069m was held by the Company's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments. Total level 3 assets represented 4% of the total assets of the participating funds at 31 December 2009.

	31 December 2009			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
With-profits				
Equity securities and portfolio holdings in unit trusts	28,484	637	398	29,519
Debt securities	3,874	26,197	330	30,401
Other investments (including derivative assets)	79	1,026	1,341	2,446
Derivative liabilities	(54)	(326)	-	(380)
Total financial investments, net of derivative liabilities	32,383	27,534	2,069	61,986
Percentage of total	52%	44%	4%	100%
Non-linked shareholder-backed				
Equity securities and portfolio holdings in unit trusts	139	2	-	141
Debt securities	536	1,871	1	2,408
Other investments (including derivative assets)	7	84	-	91
Derivative liabilities	(1)	(74)	-	(75)
Total financial investments, net of derivative liabilities	681	1,883	1	2,565
Percentage of total	27%	73%	-	100%
Company total				
Equity securities and portfolio holdings in unit trusts	28,623	639	398	29,660
Debt securities	4,410	28,068	331	32,809
Other investments (including derivative assets)	86	1,110	1,341	2,537
Derivative liabilities	(55)	(400)	-	(455)
Total financial investments, net of derivative liabilities	33,064	29,417	2,070	64,551
Percentage of total	51%	46%	3%	100%

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Notes on the financial statements (continued)

In addition to the financial investments, net of derivative liabilities, shown in the table above, the Company also has investment contract liabilities of £5,829m which are classified as Level 2.

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

The following table reconciles the value of level 3 financial instruments at 1 January 2009 to that presented at 31 December 2009. Total gains and losses recorded in the long-term technical account in the period represents realised gains and losses, including interest and dividend income, unrealised gains and losses on financial instruments classified at fair value through profit and loss and foreign exchange movements on overseas investments. All these amounts are included within "investment income" and "unrealised gains (losses)" in the long-term technical account.

	At 1 Jan 2009 £m	Total gains or (losses) in long-term technical account £m	Purchases £m	Sales £m	Transfers into level 3 £m	Transfers out of level 3 £m	At 31 Dec 2009 £m
With-profits							
Equity securities and portfolio holdings in unit trusts	376	(15)	39	(2)	-	-	398
Debt securities	380	(60)	6	(71)	100	(25)	330
Other investments (including derivative assets)	1,454	(195)	133	(51)	-	-	1,341
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,210	(270)	178	(124)	100	(25)	2,069
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	-	-	-	-	-	-	-
Total	2,210	(270)	178	(124)	100	(25)	2,069
Non-linked shareholder-backed							
Equity securities and portfolio holdings in unit trusts	-	-	-	-	-	-	-
Debt securities	1	-	-	-	-	-	1
Other investments (including derivative assets)	-	-	-	-	-	-	-
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	1	-	-	-	-	-	1
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	-	-	-	-	-	-	-
Total	1	-	-	-	-	-	1
Company total							
Equity securities and portfolio holdings in unit trusts	376	(15)	39	(2)	-	-	398
Debt securities	381	(60)	6	(71)	100	(25)	331
Other investments (including derivative assets)	1,454	(195)	133	(51)	-	-	1,341
Derivative liabilities	-	-	-	-	-	-	-
Total financial investments net of derivative liabilities	2,211	(270)	178	(124)	100	(25)	2,070
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	-	-	-	-	-	-	-
Total	2,211	(270)	178	(124)	100	(25)	2,070

Of the total losses of £270m in the period, £267m relates to Level 3 financial instruments still held at the end of the year, which can be analysed as £15m for equity securities, £61m for debt securities and £191m for other investments.

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Notes on the financial statements (continued)

Transfers between level 1 and level 2

There have been no significant transfers between level 1 and level 2 during the year.

Interest income and expense

The interest income on financial assets not at fair value through profit and loss was £123m for the year ended 31 December 2009 (2008: £678m).

The interest expense on financial liabilities not at fair value through profit and loss was £3m for the year ended 31 December 2009 (2008: £9m).

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 four types of risk, namely:

- Interest rate risk: due to changes in market interest rates,
- Liquidity risk: inability 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
- 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.

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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.

2009	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	2	10,078	-	10,080
Debt securities and other fixed income securities	30,459	2,350	-	32,809
Loans	765	918	-	1,683
Derivative asset	407	-	280	687
Cash at bank and in hand	-	856	-	856
	31,633	14,202	280	46,115
Financial Liabilities				
Amounts owed to credit institutions	-	45	-	45
Other borrowings not owed to credit institutions	-	359	-	359
Investment contracts without discretionary participation features	-	-	5,829	5,829
Derivative liabilities	261	-	194	455
	261	404	6,023	6,688

2008	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	17	5,205	-	5,222
Debt securities and other fixed income securities	25,666	2,582	-	28,248
Loans	565	1,160	-	1,725
Derivative asset	306	1	489	796
Cash at bank and in hand	-	995	-	995
	26,554	9,943	489	36,986
Financial Liabilities				
Amounts owed to credit institutions	-	61	-	61
Other borrowings not owed to credit institutions	-	-	-	-
Investment contracts without discretionary participation features	-	-	3,983	3,983
Derivative liabilities	268	-	2,409	2,677
	268	61	6,392	6,721

Liquidity Analysis

(i) Contractual maturities of financial assets and liabilities

Financial Assets

The following tables set out the contractual maturities and re-pricing dates for applicable classes of financial assets, excluding derivative assets which are separately presented. The financial assets are included in the column relating to the contractual maturities and re-pricing dates at amounts included in the balance sheet (excluding future interest receipts).

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Notes on the financial statements (continued)

2009	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	10,080	-	-	-	-	-	-	10,080
Debt securities and other fixed income securities	757	6,934	9,201	3,236	3,110	9,550	21	32,809
Loans	15	502	360	17	20	52	717	1,683
Cash at bank and in hand	856	-	-	-	-	-	-	856
	11,708	7,436	9,561	3,253	3,130	9,602	738	45,428

2008	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	5,222	-	-	-	-	-	-	5,222
Debt securities and other fixed income securities	1,033	6,136	7,170	2,365	2,729	8,770	45	28,248
Loans	12	352	703	19	20	79	540	1,725
Cash at bank and in hand	995	-	-	-	-	-	-	995
	7,262	6,488	7,873	2,384	2,749	8,849	585	36,190

Financial Liabilities

The following tables set out the contractual maturities and repricing dates for applicable classes of financial liabilities, excluding derivative liabilities and investment contracts, which are separately presented. The financial liabilities are included in the column relating to the contractual maturities and repricing dates at the undiscounted cash flows (including contractual interest payments) due to be paid assuming conditions are consistent with those of year end.

2009	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 undiscounted cashflows	Total carrying value
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial Liabilities									
Amounts owed to credit institutions	-	45	-	-	-	-	-	45	45
Other borrowings not owed to credit institutions	140	272	-	-	-	-	-	412	359
	140	317	-	-	-	-	-	457	404

2008	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 undiscounted cashflows	Total carrying value
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial Liabilities									
Amounts owed to credit institutions	-	61	-	-	-	-	-	61	61
Other borrowings not owed to credit institutions	-	-	-	-	-	-	-	-	-
	-	61	-	-	-	-	-	61	61

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Notes on the financial statements (continued)

ii) Maturity analysis of derivatives and investment contracts

The following table provides a maturity analysis of derivative assets and liabilities:

2009	Total carrying value	1 year or less	After 1 to 3 years	After 3 to 5 years	After 5 years	Total
	£m	£m	£m	£m	£m	£m
Net derivative position	232	232	-	-	-	232
2008	Total carrying value	1 year or less	After 1 to 3 years	After 3 to 5 years	After 5 years	Total
	£m	£m	£m	£m	£m	£m
Net derivative position	(1,881)	(1,881)	-	-	-	(1,881)

The net derivative positions as shown in the table above comprise the following derivative assets and liabilities:

	2009 £m	2008 £m
Derivative assets	687	796
Derivative liabilities	(455)	(2,677)
Net derivative position	232	(1,881)

The derivative assets and liabilities have been included at fair value within the 1 year or less column representing the basis on which they are managed (i.e. to manage principally asset or liability value exposures). Contractual maturities are not considered essential for an understanding of the timing of the cash flows for these instruments and in particular the Company has no cash flow hedges.

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 European Embedded Value (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 undiscounted value	Total carrying value
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
2009								
Life assurance investment contracts	3	10	13	12	11	16	65	31
2008								
Life assurance investment contracts	2	9	12	12	11	16	62	32

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 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

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Notes on the financial statements (continued)

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:

2009	With-profits business			Other		
	Insurance contracts	Investment contracts	Total	Insurance contracts	Investment contracts	Total
	%	%	%	%	%	%
0-5 years	50	28	40	33	34	34
5-10 years	26	25	25	25	22	24
10-15 years	13	19	16	18	19	18
15-20 years	6	14	10	11	11	11
20-25 years	3	9	6	7	6	6
Over 25 years	2	5	3	6	8	7

2008	With-profits business			Other		
	Insurance contracts	Investment contracts	Total	Insurance contracts	Investment contracts	Total
	%	%	%	%	%	%
0-5 years	47	26	38	30	32	30
5-10 years	26	23	25	23	22	23
10-15 years	13	19	15	18	19	18
15-20 years	7	15	10	12	12	12
20-25 years	4	11	7	8	7	8
Over 25 years	3	6	5	9	8	9

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.

The estimated sensitivity of the shareholder-backed business to a movement in interest rates of 1% and 2% as at 31 December 2009 and 2008 are as follows:

	2009				2008			
	Fall of 1% £m	Rise of 1% £m	Fall of 2% £m	Rise of 2% £m	Rise of 1% £m	Fall of 2% £m	Rise of 2% £m	
Carrying value of debt securities and derivatives	294	(249)	647	(463)	236	(204)	512	(382)
Long term business provision	(276)	231	(610)	427	(190)	162	(415)	302
Related tax effects	(5)	5	(10)	10	(13)	12	(28)	23
Net sensitivity of profit after tax and shareholders' funds	13	(13)	27	(26)	33	(30)	69	(57)

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Notes on the financial statements (continued)

Currency Risk

As at 31 December 2009, the Company held 44% and 4% (2008: 42% and 2%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency of the relevant business unit.

The financial assets, of which 90% (2008: 92%) are held by the with-profit fund, allow the fund to obtain exposure to foreign equity markets.

The financial liabilities, of which 88% (2008: 87%) 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 and Property

In addition, the shareholder backed portfolio of the Company includes equity securities and property. Excluding any second order effects on the measurement of the liabilities for future cash flow to the policyholder a fall in their value would have given rise to the following effects on pre-tax profit, profit after tax, and shareholders' equity.

	2009			2008	
	Decrease of 20% £m	Decrease of 10% £m	Decrease of 40% £m	Decrease of 20% £m	Decrease of 10% £m
Pre-tax profit	(92.0)	(46.0)	(0.8)	(0.4)	(0.2)
Related deferred tax effects	26.0	13.0	0.2	0.1	0.1
Net sensitivity of profit after tax and shareholders' funds	<u>(66.0)</u>	<u>(33.0)</u>	<u>(0.6)</u>	<u>(0.3)</u>	<u>(0.1)</u>

A 10% or 20% increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The disclosure of the effect of a 40 per cent fall for the 2008 year end was included because of the exceptional market conditions at that time. These conditions have now abated and the disclosure is no longer appropriate.

In the equity risk sensitivity analysis given above the Company has, for 2009, considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Company believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Company would be able to put in place mitigating management actions.

C. Derivatives and Hedging

The Company uses derivatives for efficient portfolio management to obtain cost effective and efficient exposure to various markets and to manage exposure to interest rate, currency, credit and other business risks.

The Company uses various interest rate derivative instruments such as interest rate swaps to reduce exposure to interest rate volatility.

The Company also uses various currency derivatives in order to limit volatility due to foreign currency exchange rate fluctuations arising on securities denominated in currencies other than sterling.

The Company also holds interest-rate sensitive investments that contain credit risks on which a certain level of defaults is expected. In order to manage the default risk on certain underlying assets and hence reduce the amount of regulatory capital held to support the assets the Company purchases swaptions.

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Notes on the financial statements (continued)

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

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

The total fair value balances of derivative assets and derivative liabilities are shown in Note 17. The notional amount of the derivatives were as follows at 31 December 2009 and 31 December 2008:

2009	Notional amount on which future payments are based	
	Asset £m	Liability £m
Cross-currency swaps	31	37
Swaptions	900	900
Futures	2,254	2,879
Forwards	19,526	19,485
Equity options	30	552
Credit default swaps	85	12
Total return swaps	420	421
Interest rate swaps	4,812	4,813

2008	Notional amount on which future payments are based	
	Asset £m	Liability £m
Cross-currency swaps	61	77
Equity index call options	17	32
Swaptions	980	980
Futures	3,265	4,045
Forwards	13,759	15,848
Single stock options	2	4
Credit default swaps	118	14
Total return swaps	479	514
Interest rate swaps	2,945	2,993

There is a delta hedging arrangement in place, the main objective being to protect the Pillar II solvency of the With-Profits business against falls in the equity markets. A theoretical equity put option representing the liabilities has been determined, based on the FTSE 100 index and a strike price of 3000. The Company sells the appropriate number of futures contracts so that the movement in market value mirrors that of the benchmark put option. The Company is therefore hedging the delta of the liabilities.

The required delta hedging position is then compared to the actual futures position on a daily basis, and the mismatch is calculated. If the mismatch is significant, then an assessment is made as to whether or not to address the balance, and how much to rebalance. Automatic rebalancing is triggered if the mismatch between the actual and required position is greater than £500m.

The Company has chosen to designate as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of certain of the Company's operational borrowings. The fair value of the derivatives designated as fair value hedges above at 31 December 2009, were liability of £1 million (2008: £nil). Movements in the fair value of the hedging instruments of a net loss of £1 million (2008: £nil) and the hedged items of a net gain of £1 million (2008: £nil) are recorded in the long term technical account in respect of the fair value hedges above.

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Notes on the financial statements (continued)

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 2009 and 2008.

	With-profits			With-profits		
	sub fund	Other funds	Total 2009	sub fund	Other funds	Total 2008
	£m	£m	£m	£m	£m	£m
S&P – AAA	6,451	778	7,229	6,777	1,938	8,715
S&P – AA+ to AA-	2,596	218	2,814	2,028	278	2,306
S&P – A+ to A-	8,056	716	8,772	6,629	688	7,317
S&P – BBB+ to BBB-	7,178	452	7,630	4,498	301	4,799
S&P – Other	1,792	24	1,816	836	6	842
	26,073	2,188	28,261	20,768	3,211	23,979
Moody's – Aaa	357	7	364	450	78	528
Moody's – Aa1 to Aa3	138	24	162	416	55	471
Moody's – A1 to A3	224	42	266	265	21	286
Moody's – Baa1 to Baa3	389	26	415	181	21	202
Moody's – Other	167	9	176	15	1	16
	1,275	108	1,383	1,327	176	1,503
Fitch	346	31	377	215	21	236
Other	2,708	80	2,788	2,463	67	2,530
Total debt securities and other fixed income securities	30,402	2,407	32,809	24,773	3,475	28,248

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 2009 which are not externally rated, £583m (2008: £723m) were internally rated AAA to A-, £1,457m (2008: £1,424m) were internally rated BBB+ to B- and £748m were internally rated as below B- or unrated (2008: £383m). The majority of the unrated debt security investments were held by the Company's with-profits fund and relate to convertible debt and other investments which are not covered by rating analysts nor have an internal rating attributed to them.

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

In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2009, impairment losses of £10m (2008: £28m) were recognised for loans and receivables.

Of the total loans and receivables held £7m (2008: £7m) are past their due date but have not been impaired. 98% (2008: 95%) of the loans and receivables that are past due but not impaired are less than one year past their due date for 2009. 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 (2008: £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

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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 2009, the Company had lent £6,393m (2008: £7,473m) of securities and held collateral under such agreements of £6,534m (2008: £7,644m).

At 31 December 2009, 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, £913m (2008: £267m), together with accrued interest.

Collateral and pledges under derivative transactions

At 31 December 2009, the Company had pledged £129m (2008: £Nil) for liabilities and held collateral of £243m (2008: £194m) in respect of over-the-counter derivative transactions.

Reinsurer's share of technical provisions

The majority of the reinsurers' share of technical provisions relate to cessions to subsidiaries of the Company or other group companies. See Note 19.

Of the reinsurer's share of technical provisions at 31 December 2009 of £16,756m (2008: £14,655m), 2% (2008: 2%) of the balance relates to companies outside of the Prudential Group and of this 11% (2008: 49%) of the balances were from reinsurers with S&P's rating of AA- and above, based on the ratings at the time of signing these financial statements.

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 arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates.

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 property investments that the Company believes produce greater

Notes on the financial statements (continued)

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 of loss to the Company if another party fails to perform its obligations, or fails to perform them in a timely manner. The Company's long-term fund holds large amounts of interest-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.

34. 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 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.

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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 and SAIF and DCPSF of £6.4bn (2008: £5.4bn) 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 £1.5bn (2008: £2.0bn) at 31 December 2009.

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.

Non-Profit Sub-Fund

The available capital of £119m (2008: £33m) reflects the excess of regulatory basis assets over liabilities of the Company. The regulatory capital resources requirement of £342m (2008: £300m) 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.

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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 2009 and 2008.

31 December 2009							
	SAIF £m	WPSF and DCPSF £m	Total with- profits fund £m	Non-profit sub-fund £m	Total life assurance £m	Shareholders' funds £m	Company total £m
Shareholders' funds							
Held outside long-term funds							
Net assets	-	-	-	-	-	3,075	3,075
Goodwill	-	-	-	-	-	-	-
Total	-	-	-	-	-	3,075	3,075
Held in long-term funds (note i)	-	-	-	624	624	-	624
Total shareholders' funds	-	-	-	624	624	3,075	3,699
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	10,330	10,330	-	10,330	-	-
Shareholders' share of realistic liabilities	-	(3,001)	(3,001)	-	(3,001)	-	-
Deferred acquisition costs of non-participating business and intangible assets (distribution rights and licence) not recognised for regulatory reporting purposes	(2)	(95)	(97)	(294)	(391)	-	-
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(91)	(91)	-	(91)	-	-
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(1,294)	(1,294)	-	(1,294)	-	-
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	2	592	594	(211)	383	-	-
Total adjustments	-	6,441	6,441	(505)	5,936		
Total available capital resources of life assurance businesses on FSA regulatory bases	-	6,441	6,441	119	6,560		

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31 December 2008							
	SAIF £m	WPSF and DCPSF £m	Total with- profits fund £m	Non-profit sub- fund £m	Total life assurance £m	Shareholders' funds £m	Company total) £m
Shareholders' funds							
Held outside long-term funds:							
Net assets	-	-	-	-	-	2,728	2,728
Goodwill	-	-	-	-	-	-	-
Total	-	-	-	-	-	2,728	2,728
Held in long-term funds (note i)	-	-	-	509	509	-	509
Total shareholders' funds	-	-	-	509	509	2,728	3,237
Adjustments to regulatory basis							
Funds for future appropriation (note ii)	-	8,691	8,691	-	8,691	-	-
Shareholders' share of realistic liabilities	-	(2,028)	(2,028)	-	(2,028)	-	-
Deferred acquisition costs of non-participating business and intangible assets (distribution rights and licence) not recognised for regulatory reporting purposes	(3)	(114)	(117)	(309)	(426)	-	-
Adjustment from FRS17 basis pension surplus attributable to WPSF to pension liability for regulatory purposes	-	(287)	(287)	-	(287)	-	-
Valuation difference on PAL between UKGAAP basis and regulatory basis	-	(1,350)	(1,350)	-	(1,350)	-	-
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) (note iii)	3	450	453	(167)	286	-	-
Total adjustments	-	5,362	5,362	(476)	4,886	-	-
Total available capital resources of life assurance businesses on FSA regulatory bases	-	5,362	5,362	33	5,395	-	-

Notes

- (i) The term shareholders' funds 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' funds 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.

35. Litigation

The Company is, and in the future may be, subject to legal actions and disputes in the ordinary course of its business. Whilst the outcome of such matters cannot be predicted with certainty, the directors believe that the ultimate outcome of such litigation will not have a material adverse effect on the Company's financial condition and results.

