Registered Number 2554213

Prudential Annuities Limited

Annual Report and Financial Statements
For the year ended 31 December 2009

Prudential Annuities Limited

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

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Prudential Annuities Limited

Directors

R A Devey (Chairman)
D J Belsham
T V Boardman
A M Crossley
F A O’Dwyer

Secretary

Prudential Group Secretarial Services Limited

Auditors

KPMG Audit Plc, London

Prudential Annuities Limited

Directors' report for the year ended 31 December 2009

Company registration number

The Company Registration number is 2554213.

Principal activity

The principal activity of Prudential Annuities Limited (the Company) in the course of 2009 was the writing of pension annuity long term insurance business. This activity will continue in 2010.

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

Business review

The results of the Company for the year as set out on pages 10 and 11, show a loss on ordinary activities before tax of £8m (2008: loss £243m).

The losses during 2009 have mainly arisen from the strengthening of the assumption for asset default. This has been partially offset by the favourable investment returns earned on the surplus assets held by the Company.

The Shareholders' capital of the Company totalled £1,545m (2008: £1,549m).

The assets and liabilities of the Company have increased during 2009 as a result of a decrease in the yield on the underlying assets, partially offset by the payment of annuity claims.

The Company's conventional annuities include level, fixed increase and retail price index (RPI) annuities. The fixed increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The RPI annuities that the Company offers provide for a regular annuity payment which changes periodically based on the change in the UK RPI.

The Company remained in a satisfactory financial position at 31 December 2009.

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

Corporate responsibility

The Company is a wholly owned subsidiary within Prudential plc and corporate responsibility (CR) is a philosophy that is firmly embedded in Prudential's operations around the world and has become a fundamental and 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 result of 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.

Prudential Annuities Limited

Directors’ report for the year ended 31 December 2009 (continued)

Corporate responsibility (continued)

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 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 our customers 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 best know 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 a 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.

Post balance sheet events

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

Results and dividends

The state of affairs of the Company at 31 December 2009 is shown in the balance sheet on pages 12 and 13. The profit and loss account appears on pages 10 and 11. No dividend for 2009 is proposed (2008: £Nil).

Share Capital

There have been no changes to the issued share capital during 2009.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2009 (continued)

Payment policy

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

Directors

The present directors are shown on page 2.

Messrs O'Dwyer and Devey were appointed as directors of the Company on 16 January and 16 November 2009 respectively. Mr Prettejohn resigned as a director on 30 September 2009. There were no other changes during the year. Mr Haasz resigned as a director on 15 January 2010.

Financial risk management objectives, policies and exposure

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

The Company's objectives and policy in relation to the management of financial risk resulting from its financial assets and liabilities are to minimise any risk. The Company's exposure to financial risk through its financial assets and liabilities is provided in detail in note 8 of the notes to the financial statements.

Disclosure to auditors

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

Auditor

In accordance with section 487(2) of the Companies Act 2006, KPMG Audit Plc will be deemed to be re-appointed auditors of the Company for the current financial year.

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 permit 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.

Prudential Group Secretarial Services Limited
Company Secretary
26 March 2010

Prudential Annuities 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 judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping 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

Prudential Annuities Limited

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

We have audited the financial statements of Prudential Annuities Limited for the year ended 31 December 2009 set out on pages 10 to 41. 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 7, 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 website at www.frc.org.uk/apd/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 loss 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 matters 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.

Prudential Annuities Limited

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

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 of 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

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2009

Long Term Business - Technical Account	Note	2009 £m	2008 £m
Earned premiums, net of reinsurance			
Gross premiums written	2(a)	**7**	(3)
		7	(3)
Investment income	3	**748**	800
Unrealised gains / (losses) on investments		**633**	(1,254)
		1,381	(454)
Claims incurred, net of reinsurance			
Claims paid		**(899)**	(913)
Change in other technical provisions, net of reinsurance			
Long term business provision, net of reinsurance	11	**(367)**	929
Technical provision for linked liabilities, net of reinsurance	11	**(125)**	156
		(492)	1,085
Net operating expenses			
Administrative expenses		**(13)**	(13)
Investment expenses and charges		**(9)**	(15)
		(22)	(28)
Tax attributable to the long term business		**7**	89
Balance on the technical account – long term business		**(18)**	(224)

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 14 to 41 form an integral part of these financial statements.

Prudential Annuities Limited

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

Non-Technical Account	Note	**2009 £m**	2008 £m
Balance on the long term business technical account		**(18)**	**(224)**
Tax attributable to the balance on the long term business technical account		**(7)**	(89)
Investment income	3	**41**	53
Unrealised (losses) / gains on investments		**(23)**	18
Investment expenses and charges		**(1)**	(1)
Loss on ordinary activities before tax		**(8)**	(243)
Tax on loss on ordinary activities	5(a)	**4**	70
Retained loss for the financial year transferred to reserves	11	**(4)**	(173)

Statement of total recognised gains and losses

Year ended 31 December 2009

	2009 £m	2008 £m
Retained loss for the financial year	**(4)**	(173)
Total gains and losses recognised since the last annual report	**(4)**	(173)

Reconciliation of movement in Shareholders' Funds

Year ended 31 December 2009

	2009 £m	2008 £m
Shareholders' capital and reserves at beginning of year	**1,549**	1,722
Retained loss for the financial year	**(4)**	(173)
Shareholders' capital and reserves at end of year	**1,545**	1,549

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 14 to 41 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2009

ASSETS	Note	**2009 £m**	2008 £m
Investments			
Land and buildings		**636**	580
Other financial investments		**11,143**	10,860
	8	**11,779**	11,440
Assets held to cover linked liabilities	10	**1,995**	1,870
Reinsurers' share of technical provisions			
Long term business provision	11	**4**	4
Technical provision for linked liabilities	11	**2**	2
		6	6
Debtors			
Other debtors	13	**73**	118
		73	118
Other assets			
Cash at bank and in hand	16	**33**	183
Prepayments and accrued income			
Accrued interest and rent		**242**	233
Total assets	2(b)	**14,128**	13,850

The accounting policies and notes on page 14 to 41 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2009 (continued)

LIABILITIES	Note	**2009 £m**	2008 £m
Capital and reserves			
Called up share capital	17	**550**	550
Profit and loss account	11	**995**	999
Total shareholders' funds		**1,545**	1,549
Technical provisions			
Long term business provision	11	**9,966**	9,599
Claims outstanding	11	**6**	7
Technical provisions for linked liabilities	11	**1,997**	1,872
Provision for other risks and charges			
Deferred tax	14	**211**	197
Creditors			
Derivative liabilities	8	**141**	280
Amounts owed to credit institutions		**237**	314
Creditors arising out of reinsurance operations		**6**	6
Other creditors including taxation and social security	15	**19**	26
		403	626
Total liabilities		**14,128**	13,850

The financial statements on pages 10 to 41 were approved by the board of directors on 26 March 2010.

A M Crossley
Director

The accounting policies and notes on page 14 to 41 form an integral part of these financial statements.

1. Accounting Polices

(a) 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 implementation of IFRS in the UK.

<u>Amendments to FRS 29 - Improving Disclosures About Financial Instruments</u>
In May 2009 the Accounting Standards Board (ASB) approved the 'Amendments to FRS 29 - Improving Disclosures About Financial Instruments', effective from Jan 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 8.

<u>Amendments to FRS 8 - Related Party Transactions</u>
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 not 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
- Improvements to Financial Reporting Standards

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

The Company has not presented a capital position statement with supporting disclosures under FRS 27 on the basis that the Company is more than 90 per cent owned within a group and the Company is included in the publicly available Prudential Group financial statements which provide information on a group basis complying with this requirement. The process for setting assumptions and determining liabilities, as required to be disclosed by FRS 27, is described in note 12 of the financial statements (together with key assumptions).

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.

1. Accounting Policies (continued)

(b) Basis of preparation (continued)

This conclusion has been based upon the following: the Company is a subsidiary within the Prudential Group and 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 9), 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 page 3, and the management of financial risk as set out in Note 8, including its exposure to liquidity risk and credit risk.

(c) Long term business

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

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

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

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

(d) Investments

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

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

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

1. Accounting Policies (continued)

(d) Investments (continued)

(iii) *Realised gains and losses on investments*
Realised gains and losses on investments represent the difference between net proceeds on disposal and the purchase price.

(iv) *Unrealised gains and losses on investments*
Unrealised gains and losses on investments represent the difference between 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.

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 on an available-for-sale basis, financial investments held to maturity, or loans and receivables. The Company holds financial investments on the following bases:

(v) *Financial investments at fair value through profit and loss*
This comprises assets designated by management as fair value through profit and loss on inception and derivatives which are 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.

The Company uses bid prices to value its quoted financial investments. Actively traded investments without quoted prices are valued using external broker bid prices. If there is no active established market for an investment, the Company applies an appropriate valuation technique such as discounted cash flow technique.

(vi) *Loans and receivables*
This comprises investments that have fixed or determinable payments and are not designated as fair value through profit and loss or available-for-sale. These investments include loans secured by mortgages, deposits and other unsecured loans and receivables. These investments 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.

(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 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.

Notes to the financial statements for the year ended 31 December 2009 (continued)

1. Accounting Policies (continued)

(f) Long term business provision

The long term business provision is determined by the Company's directors based on advice from the Company's Actuarial Function Holder, who determined the provision using recognised actuarial methods, with due regard to the actuarial principles laid down in Directive 2002/83/EC.

It is calculated initially on a statutory solvency basis to comply with the reporting requirements under the Financial Services and Markets Act 2000. The valuation is then modified to remove certain resilience, contingency and other reserves required by the Prudential Sourcebook for Insurers and the General Prudential Sourcebook issued by the Financial Services Authority.

The technical provisions are the discounted value of future claim payments, adjusted for investment expenses and future administration costs. Claim payments allow for the effects of mortality in line with the bases set out in Note 12. These bases have been derived from an analysis of recent population and internal mortality experience and include an allowance for improvements in mortality in the future.

The interest rates used for discounting claim payments are derived from the yield on the assets held and make allowance for potential defaults on those assets. Long term rates of default appropriate to the assets held have been set based on an investigation into historic rates of default by credit rating, term to redemption and security. An additional short term default provision is held to reflect market conditions at the valuation date. (See Note 12).

(g) Cash flow statement

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

(h) Taxation

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

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

(i) Foreign Currencies

Foreign currency revenue transactions are translated at the rate applied at the time of execution. Monetary foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences are included in the profit and loss account.

Notes to the financial statements for the year ended 31 December 2009 (continued)

2. Segmental analysis

(a) Gross premiums written

	2009 £m	2008 £m
Pension annuities:		
- Non-participating	**7**	(3)
	7	(3)
Comprising:		
External direct premiums:		
- Immediate annuities	**8**	-
- Deferred annuities	**-**	(1)
	8	(1)
Reinsurance from a related party:		
- Immediate annuities	**(1)**	(2)
Total	**7**	(3)

All premiums are single premium business written in the United Kingdom. Group pension scheme buyouts included in external premiums are £7m (2008: £1m of refunds).

(b) Assets attributable to the long term business fund

Of the total assets shown on page 12, £13,454m (2008: £13,122m) is attributable to the long term business fund.

3. Investment income

	Long term business technical account		**Non technical account**	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Income from equity securities	**21**	22	-	**-**
Income from land and buildings	**42**	44	-	**-**
Income from debt securities	**704**	685	**30**	50
Income from mortgage loans and other loans	**10**	10	-	**-**
Income from deposits with credit institutions	**1**	4	-	1
Income from other investments	**2**	7	**1**	**-**
Gains/(losses) on the realisation of investments other than derivatives	**(31)**	6	**10**	2
Gains on the realisation of derivatives	**1**	18	-	-
Exchange (losses) / gains	**(2)**	4	-	-
	748	800	**41**	53

4. Staff costs

The Company has no employees (2008: Nil). Included within net operating expenses are amounts paid in return for management services provided to the Company by other group companies.

5. Tax on profit on ordinary activities

(a) Analysis of charge in the period

	2009 £m	2008 £m
Current Tax		
UK Corporation tax on profits / (losses) of the period	**4**	(40)
Adjustments in respect of previous periods	**(22)**	-
	(18)	(40)
Deferred Tax		
Origination and reversal of timing differences	**(7)**	(30)
Adjustments in respect of previous periods	**21**	-
	14	(30)
Tax on losses on ordinary activities	**(4)**	(70)

(b) Factors affecting tax charge for the period

	2009 £m	2008 £m
Loss on ordinary activities before tax	**(8)**	(243)
Loss on ordinary activities multiplied by effective rate of corporation tax in the UK of 28% (2008: 28.5%)	**(2)**	(69)
Effects of		
Adjustments in respect of previous periods	**(22)**	-
Timing differences		
- Transfer from the non-technical account in excess of the statutory surplus	**16**	29
Utilisation of tax losses brought forward	**(10)**	-
Current tax credit for the period	**(18)**	(40)

6. Auditors' remuneration

Fees payable to KPMG for the audit of the Company's accounts were £53,727 (2008: £46,832). Fees payable to KPMG for other services pursuant to legislation, including the audit of the regulatory return were £11,273 (2008: £19,131).

Notes to the financial statements for the year ended 31 December 2009 (continued)

7. Directors' emoluments

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

	2009 £	2008 £
Aggregate emoluments and non-pension benefits	**143,189**	215,769

Five (2008: six) directors were entitled to shares under the Prudential's main long term incentive scheme. Three directors are entitled to retirement benefits under defined benefit schemes and two directors participate in the defined contribution scheme.

The aggregate of emoluments and amounts receivable under long term incentive schemes of the highest paid director included in the above figure was £37,464. During the year the highest paid director did not exercise any share options but he did receive shares under a long term incentive scheme.

8. Investments

	Cost		**Current Value**	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Freehold land and buildings	**333**	332	**356**	315
Leasehold land and buildings	**293**	293	**280**	265
Equity securities	**282**	328	**241**	275
Debt securities and other fixed income securities	**10,153**	10,358	**10,334**	10,158
Derivative assets	**-**	-	**78**	133
Loans secured by mortgages	**123**	127	**123**	127
Other loans	**12**	13	**12**	13
Deposits with credit institutions	**355**	154	**355**	154
	11,551	11,605	**11,779**	11,440

The change in current value of investments included in the profit and loss account was a gain of £539m (2008: loss of £1,055m) analysed between a gain of £562m (2008: loss of £1,073m) included in the Long term business technical account and a loss of £23m (2008: gain of £18m) included in the Non-technical account. The change in current value of £562m (2008: loss of £1,073m) included a gain of £60m (2008: loss of £105m) in respect of land and buildings, a gain of £72m (2008: loss of £158m) in respect of derivatives, a gain of £12m (2008: loss of £71m) in respect of equity securities and a gain of £418m (2008: loss of £739m) in respect of debt securities.

Amounts included above ascribed to listed investments:

	Current Value	
	2009 £m	2008 £m
Equity securities	**211**	243
Debt securities and other fixed income securities	**9,177**	8,990
	9,388	9,233

All Leasehold land and buildings are classed as long lease as their term is greater than 50 years.

8. Investments (continued)

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

	Freehold and leasehold land and buildings	
	2009 £m	2008 £m
At cost	**626**	625
Aggregated depreciation	**(51)**	(38)
Net book value based on historical cost	**575**	587

(a) Financial instruments

(i) 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 or amortised cost.

2009	**Fair value through profit and loss**	**Loans and receivables at Amortised cost**	**Total carrying value**	**Fair value**
		£m		
Financial Assets:				
Freehold land and buildings	**356**	**-**	**356**	**356**
Leasehold land and buildings	**280**	**-**	**280**	**280**
Deposits with credit institutions	**-**	**355**	**355**	**355**
Equity securities	**241**	**-**	**241**	**241**
Debt securities	**10,334**	**-**	**10,334**	**10,334**
Loans:				
Loans secured by mortgages	**-**	**123**	**123**	**108**
Other loans	**-**	**12**	**12**	**11**
Derivatives assets	**78**	**-**	**78**	**78**
Accrued investment income	**-**	**242**	**242**	**242**
Other Debtors	**-**	**28**	**28**	**28**
Cash at bank and in hand	**-**	**33**	**33**	**33**
	11,289	**793**	**12,082**	**12,066**
Financial Liabilities:				
Derivative Liabilities	**141**	**-**	**141**	**141**
Creditors arising out of reinsurance operations	**-**	**6**	**6**	**6**
Other creditors	**-**	**245**	**245**	**245**
	141	**251**	**392**	**392**

Notes to the financial statements for the year ended 31 December 2009 (continued)

8. Investments (continued)

(a) Financial instruments (continued)

(i) Designation and fair values (continued)

2008	Fair value through profit and loss	Loans and receivables / Amortised cost	Total carrying value	Fair value
		£m		
Financial Assets:				
Freehold land and buildings	315	-	315	315
Leasehold land and buildings	265	-	265	265
Deposits with credit institutions	-	154	154	154
Equity securities	275	-	275	275
Debt securities	10,158	-	10,158	10,158
Loans :				
Loans secured by mortgages	-	127	127	123
Other loans	-	13	13	11
Derivatives assets	133	-	133	133
Accrued investment income	-	233	233	233
Other Debtors	-	106	106	106
Cash at bank and in hand	-	183	183	183
	11,146	816	11,962	11,956
Financial Liabilities:				
Derivative liabilities	280	-	280	280
Creditors arising out of reinsurance operations	-	6	6	6
Other creditors	-	321	321	321
	280	327	607	607

As at 31 December 2009 there were no convertible bonds included in debt securities (2008: £77m). There were no convertible bonds included in borrowings (2008: £Nil).

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.

8. Investments (continued)

(a) Financial instruments (continued)

(ii) Determination of fair values

The fair values of the financial values of the financial assets and liabilities as shown in the table on the previous page 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 liquidity. 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 into 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 or 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 re realised in immediate settlement of the financial instrument.

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

The estimated fair value of derivative instruments reflects the estimated amount the Company would receive or pay in an arm's length transaction. The amount is determined using 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 of the Company is determined using discounted cash flows of the amounts expected to be paid.

8. Investments (continued)

(a) Financial instruments (continued)

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

In May 2009 FRS29 '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 year of adoption.

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

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

Level 1 principally includes exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such 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.

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

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.

The nature of the Company's operations in the UK mean that a significant proportion of the assets backing non-linked shareholder backed business are held in corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using third party broker quotes in the UK either directly or via third parties such as IDC or Bloomberg. Such assets have generally been classified as level 2 as the nature of broker quotations means that it does not strictly meet the definition of a level 1 asset. However these valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £8,928m, £1,054m 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.

8. Investments (continued)

(a) Financial instruments (continued)

(iii) Level 1, 2 and 3 fair value measurement hierarchy of financial instruments (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, investments which are internally valued or subject to a significant number of unobservable assumptions and certain derivatives which are bespoke or long dated. 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

Of the £153m level 3 items which support non-linked annuities backed business (1% of the total assets net of derivative liabilities backing this business), £68m are externally valued and £85m are internally valued. Internal valuations, which represent only 0.8% of the total assets net of derivative liabilities supporting non-linked annuities backed business, are inherently more subjective than external valuations.

If the value of all level 3 investments backing non-linked annuities backed business was varied by 10%, the change in valuation would be £15.3m, which would reduce shareholders' equity by this amount before tax.

2009	**Level 1**	**Level 2**	**Level 3**	**Total**
		£m		
Equity securities	**-**	**241**	**-**	**241**
Debt securities	**1,253**	**8,928**	**153**	**10,334**
Other investments (including derivative assets)	**-**	**78**	**-**	**78**
Derivative liabilities	**-**	**(141)**	**-**	**(141)**
Total financial investments, net of derivative liabilities	**1,253**	**9,106**	**153**	**10,512**
Percentage of total	**12%**	**87%**	**1%**	**100%**

8. Investments (continued)

(a) Financial instruments (continued)

(iii) Level 1, 2 and 3 fair value measurement hierarchy of financial instruments (continued)

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.

2009	**At 1st Jan 2009**	**Total gains or (losses) in long-term technical account**	**Purchases**	**Sales**	**Transfers into level 3**	**Transfers out of level 3**	**At 31 Dec 2009**
				£m			
Equity securities	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Debt securities	**159**	**6**	**1**	**(26)**	**42**	**(29)**	**153**
Other Investments (including derivative assets)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Derivative liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total financial investments net of derivative liabilities	**159**	**6**	**1**	**(26)**	**42**	**(29)**	**153**

Of the total gains / losses of £6m in the period, £5m relates to level 3 financial instruments still held at the end of the year, all of which are debt securities.

Transfers between level 1 and level 2

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

8. Investments (continued)

(a) Financial instruments (continued)

(iv) Interest income and expense

The interest income on financial assets not at fair value through profit and loss was £11m for the year ended 31 December 2009 (2008: £18m).

There is no interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2009 (2008: £Nil).

(b) Market risk

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).

The assets covering the Company's liabilities are principally debt securities and other investments that are held to match the expected duration and payment characteristics of the policyholder liabilities. These liabilities are valued for reporting purposes by applying discount rates that reflect the market rates of return attaching to the covering assets.

Except to the extent of any minor mismatch, the sensitivity of the results to market risk for liabilities and covering assets is broadly neutral on a net basis.

The main market risk sensitivity for the Company arises from the investment assets covering the capital of the Company. This capital comprises the net assets held within the long term fund of the Company that cover regulatory basis liabilities that are not recognised for reporting purposes, for example contingency reserves and shareholder capital held outside the long term fund.

(i) 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.

8. Investments (continued)

(b) Market risk (continued)

(i) Interest rate risk (continued)

2009	**Fair value interest rate risk**	**Cash flow interest rate risk**	**Not directly exposed to interest rate risk**	**Total**
		£m		
Financial Assets:				
Freehold land and buildings	**-**	**-**	**356**	**356**
Leasehold land and buildings	**-**	**-**	**280**	**280**
Deposits with credit institutions	**-**	**355**	**-**	**355**
Equity securities	**-**	**-**	**241**	**241**
Debt securities	**10,280**	**54**	**-**	**10,334**
Loans:				
Loans secured by mortgages	**123**	**-**	**-**	**123**
Other loans	**12**	**-**	**-**	**12**
Derivatives assets	**78**	**-**	**-**	**78**
Cash at bank and in hand	**-**	**33**	**-**	**33**
	10,493	**442**	**877**	**11,812**
Financial Liabilities:				
Derivative liabilities	**141**	**-**	**-**	**141**
	141	**-**	**-**	**141**

2008	Fair value interest rate risk	Cash flow interest rate risk	Not directly exposed to interest rate risk	Total
		£m		
Financial Assets:				
Freehold land and buildings	-	-	315	315
Leasehold land and buildings	-	-	265	265
Deposits with credit institutions	-	154	-	154
Equity securities	-	-	275	275
Debt securities	10,125	33	-	10,158
Loans:				
Loans secured by mortgages	127	-	-	127
Other loans	13	-	-	13
Derivatives assets	133	-	-	133
Cash at bank and in hand	-	183	-	183
	10,398	370	855	11,623
Financial Liabilities:				
Derivative liabilities	280	-	-	280
	280	-	-	280

Notes to the financial statements for the year ended 31 December 2009 (continued)

8. Investments (continued)

(b) Market risk (continued)

(ii) Liquidity Analysis

(i) Contractual maturities of financial assets and liabilities

In relation to interest rate exposure, the following table sets out the earlier of contractual maturities and repricing dates for applicable classes of financial assets and liabilities excluding derivative assets which are separately presented.

2009	**Less than 1 year**	**1 to 5 years**	**5 to 10 years**	**10 to 15 years**	**15 to 20 years**	**Over 20 years**	**No stated maturity**	**Total carrying value**
				£m				
Financial Assets								
Deposits with credit institutions	**355**	**-**	**-**	**-**	**-**	**-**	**-**	**355**
Debt securities	**163**	**706**	**1,603**	**2,312**	**1,809**	**3,563**	**178**	**10,334**
Loans:								
Loans secured by mortgages	**-**	**3**	**11**	**19**	**52**	**38**	**-**	**123**
Other loans	**-**	**-**	**1**	**2**	**5**	**4**	**-**	**12**
	518	**709**	**1,615**	**2,333**	**1,866**	**3,605**	**178**	**10,824**

2008	Less than 1 year	1 to 5 years	5 to 10 years	10 to 15 years	15 to 20 years	Over 20 years	No stated maturity	Total carrying value
				£m				
Financial Assets								
Deposits with credit institutions	154	-	-	-	-	-	-	154
Debt securities	220	895	1,567	2,093	2,034	3,085	264	10,158
Loans:								
Loans secured by mortgages	2	1	14	24	54	32	-	127
Other loans	1	-	-	-	12	-	-	13
	377	896	1,581	2,117	2,100	3,117	264	10,452

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Notes to the financial statements for the year ended 31 December 2009 (continued)

8. Investments (continued)

(b) Market risk (continued)

(ii) Liquidity Analysis (continued)

(ii) Maturity analysis of derivatives

2009	**Total carrying value**	**1 year or less**	**After 1 to 3 years**	**After 3 to 5 years**	**After 5 years**	**Total**
			£m			
Net derivative position	**(63)**	**(63)**	**-**	**-**	**-**	**(63)**

2008	Total carrying value	1 year or less	After 1 to 3 years	After 3 to 5 years	After 5 years	Total
			£m			
Net derivative position	(147)	(147)	-	-	-	(147)

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

	2009 £m	2008 £m
Derivative assets	**78**	133
Derivative liabilities	**(141)**	(280)
Net Derivative position	**(63)**	(147)

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 flow for these instruments and in particular the Company has no cash flow hedges.

(iii) Sensitivity to interest rate movement

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

Notes to the financial statements for the year ended 31 December 2009 (continued)

8. Investments (continued)

(b) Market risk (continued)

(ii) Liquidity Analysis (continued)

(iii) Sensitivity to interest rate movement (continued)

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

2009

	Fall of 2%	**Fall of 1%**	**Rise of 1%**	**Rise of 2%**
		£m		
Carrying value of debt securities and derivatives	**3,121**	**1,414**	**(1,194)**	**(2,217)**
Long term business provision	**(2,953)**	**(1,332)**	**1,109**	**2,044**
Related tax effects	**(47)**	**(23)**	**24**	**48**
Net sensitivity of profit after tax and shareholders' funds	**121**	**59**	**(61)**	**(125)**

2008

	Fall of 2%	Fall of 1%	Rise of 1%	Rise of 2%
		£m		
Carrying value of debt securities and derivatives	2,866	1,306	(1,113)	(2,075)
Long term business provision	(2,622)	(1,189)	999	1,847
Related tax effects	(68)	(33)	32	64
Net sensitivity of profit after tax and shareholders' funds	176	84	(82)	(164)

(iv) Currency risk

As at 31 December 2009, the Company held 4% (2008: 4%) and 40% (2008: 43%) of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency, Sterling.

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

(v) Other Price Risk – Equities and Property

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

8. Investments (continued)

(b) Market risk (continued)

(ii) Liquidity Analysis (continued)

(v) Other Price Risk – Equities and Property (continued)

2009

	A decrease of 20% £m	A decrease of 10%
Pre-tax profit	**(175)**	**(88)**
Related current tax effects	**49**	**25**
Net sensitivity of profit after tax and shareholders' funds	**(126)**	**(63)**

2008

	A decrease of 40%	A decrease of 20% £m	A decrease of 10%
Pre-tax profit	(342)	(171)	(85)
Related deferred tax effects	96	48	24
Net sensitivity of profit after tax and shareholders' funds	(246)	(123)	(61)

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 and property risk sensitivity analysis given the Company has, for 2009, considered the impact of an instantaneous 20 fall in equity and property markets. If equity and property 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 various currency derivatives in order to limit volatility due to foreign currency exchange fluctuations arising on securities denominated in currencies other than Sterling. In addition, total return swaps and interest rate swaps are held for efficient portfolio management.

The Company is party to a number of currency and interest rate swap agreements. Currency swap agreements involve the exchange of payments in different currencies over the life of the agreement. The Company enters into currency swap transactions to hedge foreign currency risk on overseas investments. Interest rate swap agreements involve the exchange of fixed and floating payments over the life of the agreements without an exchange of the underlying principle amount. The Company enters into interest swap transactions to assist in the matching of contractual liabilities. These currency and interest rate swap agreements are accounted for on a market value basis, consistent with the assets and liabilities hedged.

8. Investments (continued)

(c) Derivatives and Hedging (continued)

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 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	**Liability**
	£m	**£m**
Cross-currency swaps	**456**	**437**
Inflation swaps	**1,051**	**918**
Interest rate swaps	**549**	**549**

2008	Notional amount on which future payments are based	
	Asset	Liability
	£m	£m
Cross-currency swaps	456	489
Inflation swaps	1,117	1,117
Interest rate swaps	549	549

(i) Debt securities and other fixed income securities

The following table summarises by the rating, the securities held by the Company as at 31 December 2009 and 2008:

	Total 2009 £m	Total 2008 £m
S&P – AAA	**2,121**	2,761
S&P – AA+ to AA-	**1,095**	1,198
S&P – A+ to A-	**3,139**	2,742
S&P – BBB+ to BBB-	**1,041**	797
S&P –Other	**100**	15
	7,496	7,513
Moody's – Aaa	**51**	87
Moody's –Aa1 to Aa3	**40**	245
Moody's –A1 to A3	**232**	199
Moody's – Baa1 to Baa3	**249**	133
Moody's – Other	**59**	10
	631	674
Fitch	**264**	126
Other	**1,943**	1,845
Total debt securities	**10,334**	10,158

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

8. Investments (continued)

(c) Derivatives and Hedging (continued)

(i) Debt securities and other fixed income securities (continued)

Where no external ratings are available, internal ratings produced by the Groups' 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 2008 which are not externally rated, £848m (2008: £967m) were internally rated AAA to A-, £1,045m (2008: £871m) were internally rated BBB to B-, £nil (2008: £7m) were internally rated Other, and £50m (2008: £Nil) were unrated.

(ii) Loans and receivables

Of the total loans and receivables held £2m (2008: £7m) are past their due date but have not been impaired. Of the total past due but not impaired, £2m (2008: £7m) are less than 1 year past their due date. The Company expects full recovery of these loans and receivables.

(iii) Securities lending and reverse repurchase agreements

The Company has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be held as collateral by the agreements, depend on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Company's balance sheet, rather they are retained within the appropriate investment classification. Collateral typically consists of cash, debt securities, equity securities and letters of credit. At 31 December 2009, the Company had lent £nil (2008: £2,143m) of securities and held collateral under such agreements of £1,523m (2008: £2,193m).

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, amounting to £52m (2008: £147m), together with accrued interest. Of this amount, £nil (2008: £75m) related to another group company.

(iv) Collateral under derivative transactions

At 31 December 2009, the Company had pledged £105m (2008: £127m) for liabilities and held collateral of £15m (2008: £Nil) in respect of OTC (over-the-counter) derivatives transactions.

(d) Reinsurer's share of technical provisions

Of the reinsurer's share of technical provisions at 31 December 2009 of £6m (2008: £6m), 100% (2008: 100%) of the balance relates to companies outside of the Prudential Group and of these 100% (2008: 100%) of the balance were from reinsurers with S&P's rating of A+ and above, based on the ratings at the date 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.

8. Investments (continued)

(e) Risk management (continued)

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

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

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.

<u>Market risk</u>

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 is interest rate risk because most of its assets are investments that are bonds, mortgages or cash deposits, the values of which are subject to interest rate risk.

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

<u>Credit risk</u>

Credit risk is the risk of loss to the Group 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 rate sensitive investments that contain credit risk on which a certain level of defaults is expected. These expected losses are considered when the Company determines the crediting rates, deposit rates and premium rates for the products that will be supported by these assets. Certain over-the-counter derivatives contain a credit risk element that is controlled through evaluation of collateral agreements and master netting agreements on interest rate and currency swaps. The Company is also exposed to credit-related losses in the event of non-performance by counterparties.

<u>Liquidity risk</u>

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 reduces the liquidity risk.

9. 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, of which the Company is a part, is currently subject to the solvency requirements of the Insurance Groups Directive (IGD) as implemented by the FSA. Under the IGD a continuous parent company solvency test is applied: Under this test the surplus 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 Insurance Prudential Sourcebook, 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 Insurance Prudential Sourcebook 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.

The available capital of £770m (2008: £700m) reflects the excess of regulatory basis assets over liabilities of the fund, before deduction of the capital resources requirement of £518m (2008: £501m).

The capital resources requirement for this Company broadly reflects a formula which, for active funds, equates to a percentage of regulatory reserves plus a percentage of death strains.

	2009	2008
	£m	£m
Shareholders' equity		
Held outside long term funds:		
Net assets	**665**	651
Total	**665**	651
Held in long term funds	**880**	898
Total shareholders' equity	**1,545**	1,549
Adjustments to regulatory basis		
Other adjustments to restate these amounts to a regulatory basis	**(775)**	(849)
Total adjustments	**(775)**	(849)
Total available capital resources on FSA regulatory bases	**770**	700

Notes to the financial statements for the year ended 31 December 2009 (continued)

10. Assets held to cover linked liabilities

	Cost		Current Value	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Assets held to cover linked liabilities	**1,676**	1,623	**1,995**	1,870

The change in current value of assets held to cover linked liabilities included in the Long term business technical account was a gain of £71m (2008: loss of £181m).

11. Reserves and policyholder liabilities (net of reinsurance)

	Claims Outstanding	**Technical provision for linked liabilities**	**Long term business provision**	**Profit and loss account**
			£m	
Balance at 1 January 2009	**7**	**1,870**	**9,595**	**999**
Movement in:				
- Movement in technical provisions for the year	**(1)**	**125**	**367**	**-**
- Profit and loss account	**-**	**-**	**-**	**(4)**
Balance at 31 December 2009	**6**	**1,995**	**9,962**	**995**

Of the balance on the profit and loss account of £995m (2008: £999m), £251m (2008: £199m) is distributable to the shareholder. The remaining balance on the profit and loss account is not distributable due to the need to maintain the required margin of solvency, as computed under the rules of the FSA's Interim Prudential Sourcebook, Insurance Prudential Sourcebook and General Prudential Sourcebook.

12. Long term business provisions

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

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

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

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

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

Notes to the financial statements for the year ended 31 December 2009 (continued)

12. Long term business provisions (continued)

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

The provisions are the present value of the annuity payments and expenses. The calculation of the provisions requires a number of actuarial assumptions regarding future experience to be made. The assumptions are set by the Directors having regard to actuarial advice and based on analysis of relevant past and current data and information on anticipated future trends.

The key assumptions made at 31 December 2008 and 31 December 2009 are shown below.

Mortality

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

Recent mortality experience has been broadly in line with expectations, and no change has been required to the mortality assumptions at 31 December 2009.

The mortality assumptions also include an allowance for expected future improvements in longevity (expressed as a percentage of a standard improvement table, subject to a minimum level). The assumptions used (shown as a range of percentages of base tables with future improvements), before any allowance for impairment, are set out below:

	2009		2008	
	Males	**Females**	Males	Females
In payment:	102% - 126% PNMA00 (C=2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120.	84% - 117% PNFA00 (C=2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120.	102% - 126% PNMA00 (C=2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	84% - 117% PNFA00 (C=2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120.
In deferment:	AM92 - 4 years	AF92 - 4 years	AM92 - 4 years	AF92 - 4 years

Notes to the financial statements for the year ended 31 December 2009 (continued)

12. Long term business provisions (continued)

Interest rate

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

- additional margins for prudence required in setting the valuation interest rate for the valuation of liabilities for statutory solvency purposes have been removed;
- the Company is required, by an order issued under section 148 of the Financial Services and Markets Act 2000, to calculate the valuation rate of interest by reference to the aggregate yield on the assets rather than the market weighted gross redemption yield which is normally required by the Valuation Rules.

The valuation interest rates are adjusted to reflect investment management expenses and the risk of default on the assets.

The investment management expenses are reviewed annually and reflect the Company's costs.

The credit risk assumption is also reviewed annually and reflects the assets actually held. The assumption about the future level of defaults has been increased to 71 basis points per annum (64 basis points per annum at 31 December 2008). This increase reflects changes to the asset mix which have occurred over the course of 2009.

Expenses

An allowance is made for expenses. This allowance is reviewed annually following an investigation into the Company's costs.

Other assumptions

A number of other, less financially significant, actuarial assumptions are made in calculating the provisions, including the likely marital status of joint-life policyholders on death and the future rates of escalation of certain benefits.

13. Debtors

Other Debtors	**2009 £m**	2008 £m
Amounts due from group undertakings	**26**	101
Tax recoverable	**45**	12
Other Debtors	**2**	5
	73	118

14. Provision for deferred tax

	2009 £m	2008 £m
Unrealised (gains) on investments	**(5)**	(3)
Transfer to the non-technical account in excess of the statutory surplus	**281**	295
Unrelieved losses carried forward	**(64)**	(94)
Capital allowances on items expensed in the accounts	**(1)**	(1)
Undiscounted provision for deferred tax	**211**	197

	2009 £m	2008 £m
Deferred tax liability at start of year	**197**	227
Deferred tax charge / (credit) in profit and loss account	**14**	(30)
Deferred tax liability at end of year	**211**	197

15. Creditors

All creditors are payable within a period of five years.

Other creditors including taxation and social security	**2009 £m**	2008 £m
Taxation	**11**	19
Other creditors	**8**	7
	19	26

16. Bank current accounts

Under the terms of the Company's arrangements with the Prudential Group's main UK banker (HSBC), 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.

17. Called up share capital

The total number of issued and fully paid shares at the year end was £550,000,000 (2008: £550,000,000) ordinary shares.

18. Charges

In the normal course of business certain reinsurance liabilities were secured by a floating charge, ranking these liabilities equally with amounts due under unsecured direct (non-reassurance) policies, over the long term insurance assets of the Company. Amounts secured by charges of this nature was £7,157.0m (2008: £6,968.1m), representing liabilities to one customer.

Notes to the financial statements for the year ended 31 December 2009 (continued)

19. Related party transactions

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

20. Immediate and ultimate parent company

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