

Registered Number 2554213

Prudential Annuities Limited

**Annual Report and Financial Statements
For the year ended 31 December 2010**

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
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 2010

Company Registration number

The Company Registration number is 2554213.

Principal activity

The principal activity of Prudential Annuities Limited (the Company) is the writing of pension annuity long term insurance business. This will continue in 2011.

The Company ceased to accept annuity business reassured from group companies during 2004. This represented the majority of the Company's new business.

Business review

The results of the Company for the year as set out on pages 10 and 11, show a profit on ordinary activities before tax of £238m (2009: loss of £8m).

The profits during 2010 have mainly arisen from favourable investment returns earned on the surplus assets held by the Company.

The Shareholders' funds of the Company total £1,824m (2009: £1,545m).

The assets and liabilities of the Company have increased during 2010 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 2010.

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 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.

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.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2010 (continued)

Corporate responsibility (continued)

The Group, of which the Company is a part, has developed a Group Governance Framework which is underpinned by a Group Governance Manual and associated processes. This encompasses all key policies and procedures for example, the Group Code of Business Conduct.

The CR activities are framed around four core themes:

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

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 an annual basis. Below the Board, the Responsibility Committee comprises senior representatives from relevant Group functions and each of our core businesses. This committee is responsible for monitoring the Group's CR activities and for raising issues that need to be addressed.

Post balance sheet events

Finance (no. 2) Act 2010 enacted the reduction in corporation tax rate from 28% to 27% with effect from April 2011. In addition, the UK Government announced three further annual 1% cuts to reduce the rate to 24% from April 2014.

At Budget 2011 on 23rd March 2011 the UK Government announced that the corporation tax rate would instead reduce to 26% from April 2011 with three further annual 1% cuts to 23% by April 2014.

Other than the enacted change to 27%, the effects of the announced changes are not reflected in the financial statements for the year ended 31 December 2010 as they have not yet been enacted and the impact has not yet been estimated.

Results and dividends

The state of affairs of the Company at 31 December 2010 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 2010 is proposed (2009: £Nil).

Share Capital

100,000,000 (2009: Nil) £1 Ordinary shares were issued at par during the year.

Payment policy

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

Prudential Annuities Limited

Directors' report for the year ended 31 December 2010 (continued)

Directors

The present directors are shown on page 2.

Mr Haasz and Mr Boardman resigned as directors of the Company on 15 January 2010 and 31 March 2010 respectively. There were no other changes during the year.

Financial risk management objectives, policies and exposure

The Company is a wholly owned subsidiary of 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 risk governance framework is based on the concept of three lines of defence: risk management, risk oversight and independent assurance.

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.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2010 (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 2010 and remain in force.

On behalf of the board of directors.

Prudential Group Secretarial Services Limited
Company Secretary
28 March 2011

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

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

28 March 2011

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 2010 set out on pages 10 to 40. 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, and express an opinion on, 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/apb/scope/private.cfm.

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 2010 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 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 matters where the Companies Act 2006 requires us 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

15 Canada Square

Canary Wharf

London

E14 5GL

28 March 2011

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2010

Long Term Business - Technical Account	Note	2010 £m	2009 £m
Earned premiums, net of reinsurance			
Gross premiums written	2(a)	1	7
		1	7
Investment income	3	829	748
Unrealised gains on investments		575	633
		1,404	1,381
Claims incurred, net of reinsurance			
Claims paid		(896)	(899)
Change in other technical provisions, net of reinsurance			
Long term business provision, net of reinsurance	11	(180)	(367)
Technical provision for linked liabilities, net of reinsurance	11	(132)	(125)
		(312)	(492)
Net operating expenses			
Administrative expenses		(12)	(13)
Investment expenses and charges		(10)	(9)
		(22)	(22)
Tax attributable to the long term business		(41)	7
Balance on the technical account – long term business		134	(18)

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 14 to 40 form an integral part of these financial statements.

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2010 (continued)

Non-Technical Account	Note	2010 £m	2009 £m
Balance on the long term business technical account		134	(18)
Tax attributable to the balance on the long term business technical account		41	(7)
Investment income	3	32	41
Unrealised gains / (losses) on investments		32	(23)
Investment expenses and charges		(1)	(1)
Profit / (Loss) on ordinary activities before tax		238	(8)
Tax on profit / (loss) on ordinary activities	5(a)	(59)	4
Retained profit / (loss) for the financial year transferred to reserves	11	179	(4)

Statement of total recognised gains and losses

Year ended 31 December 2010

	2010 £m	2009 £m
Retained profit / (loss) for the financial year	179	(4)
Total gains and losses recognised since the last annual report	179	(4)

Reconciliation of movement in Shareholders' Funds

Year ended 31 December 2010

	2010 £m	2009 £m
Shareholders' capital and reserves at beginning of year	1,545	1,549
New share capital subscribed	100	-
Retained profit / (loss) for the financial year	179	(4)
Shareholders' capital and reserves at end of year	1,824	1,545

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 14 to 40 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2010

ASSETS	Note	2010 £m	2009 £m
Investments			
Land and buildings		640	636
Other financial investments		11,704	11,143
	8	12,344	11,779
Assets held to cover linked liabilities	10	2,127	1,995
Reinsurers' share of technical provisions			
Long term business provision	11	5	4
Technical provision for linked liabilities	11	2	2
		7	6
Debtors			
Other debtors	13	61	73
Other assets			
Cash at bank and in hand	16	82	33
Prepayments and accrued income			
Accrued interest and rent		232	242
Total assets	2(b)	14,853	14,128

The accounting policies and notes on page 14 to 40 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2010 (continued)

LIABILITIES	Note	2010 £m	2009 £m
Capital and reserves			
Called up share capital	17	650	550
Profit and loss account	11	1,174	995
Total shareholders' funds		1,824	1,545
Technical provisions			
Long term business provision	11	10,147	9,966
Claims outstanding	11	5	6
Technical provisions for linked liabilities	11	2,129	1,997
Provision for other risks and charges			
Deferred tax	14	238	211
Creditors			
Derivative liabilities	8	180	141
Amounts owed to credit institutions		307	237
Creditors arising out of reinsurance operations		1	6
Other creditors including taxation and social security	15	22	19
		510	403
Total liabilities		14,853	14,128

The financial statements on pages 10 to 40 were approved by the board of directors on 28 March 2011.

A M Crossley
Director

The accounting policies and notes on page 14 to 40 form an integral part of these financial statements.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010

1. Accounting Policies

(a) Change in accounting policies

There have been no changes to accounting policies that were required to be applied in preparing the Company's results for the year ended 31 December 2010.

(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 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.

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.

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 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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

1. Accounting Policies (continued)

(c) Long Term Business (continued)

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 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.

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

(v) *Financial investments at fair value through profit and loss*

This comprises assets designated by management as fair value through profit and loss on inception 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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

1. Accounting Policies (continued)

(d) Investments (continued)

(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.

(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 (see Note 12). 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.

(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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

1. Accounting Policies (continued)

(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.

2. Segmental analysis

(a) Gross premiums written

	2010 £m	2009 £m
Pension annuities:		
- Level and fixed increasing	1	7
	1	7
Comprising:		
External direct premiums:		
- Immediate annuities	1	8
	1	8
Reinsurance from a related party:		
- Immediate annuities	-	(1)
Total	1	7

All premiums are single premium business written in the United Kingdom. Group pension schemes included in external premiums are £1m (2009: £7m).

(b) Assets attributable to the long term business fund

Of the total assets shown on page 12, £13,976m (2009: £13,454m) is attributable to the long term business fund.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

3. Investment income

	Long term business technical account		Non technical account	
	2010 £m	2009 £m	2010 £m	2009 £m
Income from equity securities	14	21	-	-
Income from land and buildings	38	42	-	-
Income from debt securities	689	704	31	30
Income from mortgage loans and other loans	9	10	-	-
Income from deposits with credit institutions	1	1	-	-
Income from other investments	5	2	1	1
Gains/(losses) on the realisation of investments other than derivatives	72	(31)	-	10
Gains on the realisation of derivatives	1	1	-	-
Exchange (losses)	-	(2)	-	-
	829	748	32	41

4. Staff costs

The Company has no employees (2009: 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

	2010 £m	2009 £m
Current Tax		
UK Corporation tax on profits of the period	17	4
Adjustments in respect of previous periods	15	(22)
	32	(18)
Deferred Tax		
Origination and reversal of timing differences	41	(7)
Adjustments in respect of previous periods	(14)	21
	27	14
Tax on profits / (losses) on ordinary activities	59	(4)

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

5. Tax on profit on ordinary activities (continued)

(b) Factors affecting tax charge for the period

	2010 £m	2009 £m
Profit / (loss) on ordinary activities before tax	238	(8)
Profit / (loss) on ordinary activities multiplied by effective rate of corporation tax in the UK of 28% (2009: 28%)	67	(2)
<i>Effects of</i>		
Adjustments in respect of previous periods	15	(22)
Timing differences		
- Transfer from the non-technical account in excess of the statutory surplus	20	16
Utilisation of tax losses brought forward	(70)	(10)
Current tax charge / (credit) for the period	32	(18)

6. Auditors' remuneration

Fees payable to KPMG Audit Plc (KPMG) for the audit of the Company's accounts were £54,000 (2009: £53,727). Fees payable to KPMG for other services pursuant to legislation, including the audit of the regulatory return were £13,000 (2009: £11,273).

7. Directors' emoluments

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

	2010 £	2009 £
Aggregate emoluments and non-pension benefits	108,604	143,189

During the year five (2009: five) 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 four 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 £39,937 (2009: £37,464). During the year the highest paid director did not exercise any share options or receive any shares under a long term incentive scheme.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments

	Cost		Current Value	
	2010 £m	2009 £m	2010 £m	2009 £m
Freehold land and buildings	295	333	358	356
Leasehold land and buildings	293	293	282	280
Equity securities	292	282	259	241
Debt securities and other fixed income securities	10,171	10,153	10,816	10,334
Derivative assets	-	-	101	78
Loans secured by mortgages	118	123	118	123
Other loans	11	12	11	12
Deposits with credit institutions	399	355	399	355
	11,579	11,551	12,344	11,779

The change in current value of investments included in the profit and loss account was a gain of £507m (2009: gain of £539m) analysed between a gain of £475m (2009: gain of £562m) included in the Long term business technical account and a gain of £32m (2009: loss of £23m) included in the Non-technical account. The change in current value of £475m (2009: gain of £562m) included a gain of £43m (2009: gain of £60m) in respect of land and buildings, a loss of £15m (2009: gain of £72m) in respect of derivatives, a gain of £8m (2009: gain of £12m) in respect of equity securities and a gain of £439m (2009: gain of £418m) in respect of debt securities.

Amounts included in the above ascribed to listed investments:

	Current Value	
	2010 £m	2009 £m
Equity securities	212	211
Debt securities and other fixed income securities	9,655	9,177
	9,867	9,388

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

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

	Freehold and leasehold land and buildings	
	2010 £m	2009 £m
At cost	588	626
Aggregated depreciation	(59)	(51)
Net book value based on historical cost	529	575

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(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.

2010	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
£m				
Financial Assets:				
Freehold land and buildings	358	-	358	358
Leasehold land and buildings	282	-	282	282
Deposits with credit institutions	-	399	399	399
Equity securities	259	-	259	259
Debt securities	10,816	-	10,816	10,816
Loans:				
Loans secured by mortgages	-	118	118	97
Other loans	-	11	11	9
Derivatives assets	101	-	101	101
Accrued investment income	-	232	232	232
Other debtors	-	30	30	30
Cash at bank and in hand	-	82	82	82
Assets held to cover linked liabilities	2,127	-	2,127	2,127
	13,943	872	14,815	14,792
Financial Liabilities:				
Derivative liabilities	180	-	180	180
Creditors arising out of reinsurance operations	-	1	1	1
Other creditors	-	312	312	312
	180	313	493	493

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(a) Financial instruments (continued)

(i) Designation and fair values (continued)

2009	Fair value through profit and loss	Loans and receivables	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
Assets held to cover linked liabilities	1,995	-	1,995	1,995
	13,284	793	14,077	14,061
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

As at 31 December 2010 there were no convertible bonds included in debt securities (2009: £Nil). There were no convertible bonds included in borrowings (2009: £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 2010 and 2009.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

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 tables on the previous pages 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 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 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, 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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(a) Financial instruments (continued)

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

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.

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 £8,821m (2009: £8,928m), £1,087m (2009: £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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

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 £122m (2009: £153m) level 3 items which support non-linked annuities backed business (1% (2009: 1%) of the total assets net of derivative liabilities backing this business), £70m (2009: £68m) are externally valued and £52m (2009: £85m) are internally valued. Internal valuations, which represent only 0.5% (2009: 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 £12.2m (2009: £15.3m), which would reduce or increase shareholders' equity by this amount before tax.

2010	Level 1	Level 2	Level 3	Total
	£m			
Equity securities	1	258	-	259
Debt securities	1,873	8,821	122	10,816
Other investments (including derivative assets)	-	101	-	101
Assets held to cover linked liabilities	358	1,693	-	2,051
Derivative liabilities	-	(180)	-	(180)
Total financial investments, net of derivative liabilities	2,232	10,693	122	13,047
Percentage of total	17%	82%	1%	100%

The difference in Assets held to cover linked liabilities shown in the above table compared to that shown in the Designation and fair values table earlier is due to assets not covered by the disclosure requirements of FRS29.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(a) Financial instruments (continued)

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

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
Assets held to cover linked liabilities	152	1,780	-	1,932
Derivative liabilities	-	(141)	-	(141)
Total financial investments, net of derivative liabilities	1,405	10,886	153	12,444
Percentage of total	12%	87%	1%	100%

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 2010 to that presented at 31 December 2010. 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.

2010	At 1 Jan 2010	Total gains in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2010
£m							
Debt securities	153	35	-	(41)	1	(26)	122
Total financial investments net of derivative liabilities	153	35	-	(41)	1	(26)	122

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

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 (continued)

2009	At 1 Jan 2009	Total gains in long- term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2009
£m							
Debt securities	159	6	1	(26)	42	(29)	153
Total financial investments net of derivative liabilities	159	6	1	(26)	42	(29)	153

Of the total gains of £35m (2009: £6m gain) in the period, £25m gain (2009: £5m gain) relates to level 3 financial instruments still held at the end of the year, all of which relate to debt securities.

Transfers between level 1 and level 2

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

(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 2010 (2009: £11m).

There is no interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2010 (2009: £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).

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(b) Market risk (continued)

The financial assets covering the Company's liabilities 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 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 principal items affecting the results of the Company are mortality experience and assumptions and credit risk.

(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.

2010	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	-	-	358	358
Leasehold land and buildings	-	-	282	282
Deposits with credit institutions	-	399	-	399
Equity securities	-	-	259	259
Debt securities	10,706	110	-	10,816
Loans:				
Loans secured by mortgages	118	-	-	118
Other loans	11	-	-	11
Derivatives assets	101	-	-	101
Cash at bank and in hand	-	82	-	82
	10,936	591	899	12,426
Financial Liabilities:				
Derivative liabilities	180	-	-	180
	180	-	-	180

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

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

(ii) Maturity analysis of derivatives

The net derivative position as at 31 December 2010 was a liability of £79m (2009 : liability of £63m)

The net derivative positions as stated above comprise the following derivative assets and liabilities:

	2010 £m	2009 £m
Derivative assets	101	78
Derivative liabilities	(180)	(141)
Net Derivative position	(79)	(63)

The derivative assets and liabilities have been included at fair value and their maturity within 1 year or less which represents 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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(b) Market risk (continued)

(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.

The estimated sensitivity of the non-linked annuities backed business to a movement in the interest rates of 1% and 2% as at 31 December 2010 and 2009 are as follows:

2010	Fall of 2%	Fall of 1%	Rise of 1%	Rise of 2%
	£m			
Carrying value of debt securities and derivatives	3,478	1,563	(1,305)	(2,416)
Long term business provision	(3,120)	(1,403)	1,162	2,137
Related tax effects	(97)	(43)	39	75
Net sensitivity of profit after tax and shareholders' funds	261	117	(104)	(204)

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)

(iv) Currency risk

As at 31 December 2010, the Company held 4% (2009: 4%) and 38% (2009: 40%) 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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(b) Market risk (continued)

(v) Other Price Risk – Equities and Property

In addition the annuities 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.

2010

	A decrease of 20%	A decrease of 10%
	£m	
Pre-tax profit	(180)	(90)
Related current tax effects	49	24
Net sensitivity of profit after tax and shareholders' funds	(131)	(66)

2009

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

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

In the equity and property risk sensitivity analysis given the Company has, for 2010, considered the impact of an instantaneous 20 per cent 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 derivative arrangements in order to assist in the matching of contractual liabilities.

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 and inflation swap agreements involve the exchange of fixed and floating payments over the life of the agreements without an exchange of the underlying principal amount. The Company has entered into credit default swap arrangements only in respect of sovereign government debt obligations.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(c) Derivatives and Hedging (continued)

The swap agreements are accounted for on a market value basis, consistent with the assets and liabilities hedged. 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 master market agreements.

The notional amount of the derivatives were as follows at 31 December 2010 and 2009:

2010	Notional amount on which future payments are based	
	Asset £m	Liability £m
Cross-currency swaps	403	482
Inflation swaps	1,100	964
Credit default swaps	112	-
Interest rate swaps	549	549
<hr/>		
2009	Notional amount on which future payments are based	
	Asset £m	Liability £m
Cross-currency swaps	456	437
Inflation swaps	1,051	918
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 2010 and 2009:

	Total 2010 £m	Total 2009 £m
S&P – AAA	2,797	2,121
S&P – AA+ to AA-	1,195	1,095
S&P – A+ to A-	3,296	3,139
S&P – BBB+ to BBB-	905	1,041
S&P –Other	108	100
	<hr/>	<hr/>
	8,301	7,496
Moody's – Aaa	55	51
Moody's –Aa1 to Aa3	50	40
Moody's –A1 to A3	154	232
Moody's – Baa1 to Baa3	240	249
Moody's – Other	31	59
	<hr/>	<hr/>
	530	631
Fitch	81	264
Other	1,904	1,943
Total debt securities	<hr/>	<hr/>
	10,816	10,334

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(c) Derivatives and Hedging (continued)

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

In the table on the previous page, 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.

Where no external ratings are available, internal ratings produced by the Prudential'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 2010 which are not externally rated, £978m (2009: £848m) were internally rated AAA to A-, £907m (2009: £1,045m) were internally rated BBB to B-, £Nil (2009: £Nil) were internally rated Other, and £19m (2009: £50m) were unrated.

(ii) Loans and receivables

Of the total loans and receivables held £5m (2009: £2m) are past their due date but have not been impaired. Of the total past due but not impaired, £5m (2009: £2m) are less than 1 year past their due date. The Company expects full recovery of these loans and receivables. In accordance with accounting policy, impairment reviews were performed for loans and receivables. During the year ended 31 December 2010, no impairment losses (2009: £Nil) were recognised for 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 2010, the Company had lent £1,472m (2009: £2,488m) of securities and held collateral under such agreements of £1,580m (2009: £1,523m).

At 31 December 2010, 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 £93m (2009: £147m), together with accrued interest. Of this amount, £Nil (2009: £Nil) related to another group company.

(iv) Collateral under derivative transactions

At 31 December 2010, the Company had pledged £121m (2009: £105m) for liabilities and held collateral of £31m (2009: £15m) in respect of over-the-counter derivatives transactions.

(d) Reinsurer's share of technical provisions

Of the reinsurer's share of technical provisions at 31 December 2010 of £7m (2009: £6m), 100% (2009: 100%) of the balance relates to companies outside of the Prudential Group and of these 100% (2009: 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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

8. Investments (continued)

(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 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.

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 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.

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

Liquidity risk

Liquidity risk is the risk that the Company may be unable to meet payment of obligations in a timely manner at a reasonable cost or the risk of unexpected increases in the cost of funding the portfolio at appropriate maturities or rates. The Company writes solely annuity business, which cannot be surrendered. Therefore liquidity risk is mitigated by cashflow matching the maturity profile of investments with the expected regular annuity payments.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

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 £1,150m (2009: £770m) reflects the excess of regulatory basis assets over liabilities of the fund, before deduction of the capital resources requirement of £528m (2009: £518m).

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.

	2010	2009
	£m	£m
Shareholders' equity		
Held outside long term funds:		
Net assets	809	665
Total	809	665
Held in long term funds	1,015	880
Total shareholders' equity	1,824	1,545
Adjustments to regulatory basis		
Other adjustments to restate these amounts to a regulatory basis	(674)	(775)
Total adjustments	(674)	(775)
Total available capital resources on FSA regulatory bases	1,150	770

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

10. Assets held to cover linked liabilities

	Cost		Current Value	
	2010 £m	2009 £m	2010 £m	2009 £m
Assets held to cover linked liabilities	1,697	1,676	2,127	1,995

The change in current value of assets held to cover linked liabilities included in the Long term business technical account was a gain of £100m (2009: gain of £71m).

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 2010	6	1,995	9,962	995
Movement in:				
- Movement in technical provisions for the year	(1)	132	180	-
- Profit and loss account	-	-	-	179
Balance at 31 December 2010	5	2,127	10,142	1,174

Of the balance on the profit and loss account of £1,174m (2009: £995m), £622m (2009: £251m) 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 which changes periodically based on the change in the UK Retail Prices Index, which for some contracts are subject to pre-defined minima and maxima.

Prudential Annuities Limited

**Notes to the financial statements for the year ended 31 December 2010
(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 2009 and 31 December 2010 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. The base mortality assumptions for the majority of the business have been updated during 2010 to use the PCxA tables. Previously the PNxA tables were used, which reflected normal retirements only. The PCxA tables reflect all retirements and have been found to provide a better fit to experience.

The mortality assumptions also include an allowance for expected future improvements in longevity. The allowance for expected future improvements has, for the majority of the business, been updated during 2010 to the following. For males, the future mortality improvements are in line with Prudential’s own calibration of the CMI 2009 mortality model, with a long term improvement rate of 2.25% p.a. For females, the future mortality improvements are in line with Prudential’s own calibration of the CMI 2009 mortality model, with a long term improvement rate of 1.25% p.a. The assumptions used (shown as a range of percentages of base tables with future improvements), before any allowance for impairment, are set out below:

	2010		2009	
	Males	Females	Males	Females
In payment: Business Administered On GPDA System:	126% PNMA00 (C=2000) with medium cohort improvement table with a minimum annual improvement of 2.25% p.a. up to age 90, tapering to zero at age 120.	117% PNFA00 (C=2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% p.a. up to age 90, tapering to zero at age 120.	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	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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

12. Long term business provisions (continued)

	2010		2009	
	Males	Females	Males	Females
All other business:	92% - 98% PCMA00 with future improvements in line with Prudential's own calibration of the CMI model, with a long term improvement rate of 2.25%	88% - 100% PCFA00 with future improvements in line with Prudential's own calibration of the CMI model, with a long term improvement rate of 1.25%.	102% - 111% 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% - 103% 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

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 decreased to 56 basis points per annum (71 basis points per annum at 31 December 2009). This reduction largely reflects an improvement in the asset portfolio as a result of the sale of some lower quality assets during 2010.

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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

13. Debtors

Other Debtors	2010 £m	2009 £m
Amounts due from group undertakings	27	26
Tax recoverable	31	45
Other Debtors	3	2
	61	73

14. Provision for deferred tax

	2010 £m	2009 £m
Unrealised gains on investments	(6)	(5)
Transfer to the non-technical account in excess of the statutory surplus	252	281
Unrelieved losses carried forward	(8)	(64)
Capital allowances on items expensed in the accounts	-	(1)
Undiscounted provision for deferred tax	238	211

	2010 £m	2009 £m
Deferred tax liability at start of year	211	197
Deferred tax charge in profit and loss account	27	14
Deferred tax liability at end of year	238	211

From April 2011 the standard corporation tax rate for the UK will change from 28% to 27%. Subsequent phased rate changes to 24% are also proposed but are not yet substantially enacted. Deferred tax at the end of 2010 has been provided wholly at the rate of 27% on the basis that all of the temporary differences will reverse at the new rate. The effect of this change on the deferred tax assets and liabilities at 31 December 2010 is £8.8m.

15. Creditors

All creditors are payable within a period of five years.

Other creditors including taxation and social security	2010 £m	2009 £m
Taxation	17	11
Other creditors	5	8
	22	19

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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2010 (continued)

17. Called up share capital

The total number of issued and fully paid shares at the year end was 650,000,000 (2009: 550,000,000) £1 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 £7,312.7m (2009: £7,157.0m), representing liabilities to one customer.

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.