

Registered Number 2554213

Prudential Annuities Limited

**Annual Report and Financial Statements
For the year ended 31 December 2011**

Prudential Annuities Limited

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

Contents	Page
Directors and officers	2
Directors' report	3-7
Statement of directors' responsibilities	8
Independent auditor's report	9-10
Profit and loss account	11-12
Reconciliation of movement in Shareholders' Funds	12
Balance sheet	13-14
Notes to the financial statements	15-43

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 2011

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 2012.

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 11 and 12, show a loss on ordinary activities before tax of £21m (2010: profit of £238m).

As at 31 August 2011 the majority of the annuities previously reinsured from The Prudential Assurance Company (PAC) to the Company were recaptured by PAC. These recaptured annuities were previously valued as part of the business of this Company. The Boards of PAC and the Company agreed that the recapture premium should be equal to the value of transferring business, as measured on the prudent statutory basis ('Pillar 1, Peak 1') and hence assets of this value were transferred from the Company to PAC with an effective date of 31 August 2011. As a result, both the assets and liabilities of the Company have decreased significantly during 2011. Since the value of assets transferred to PAC was greater than the UK GAAP valuation of the transferring liabilities this resulted in a loss on ordinary activities.

The remaining assets and liabilities of the Company have increased during 2011 as a result of a decrease in the yield on the underlying assets, partially offset by the payment of annuity claims.

The Shareholders' funds of the Company total £1,422m (2010: £1,824m).

The Company's conventional annuities include level, fixed increase and inflation linked annuities. The fixed increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The inflation linked annuities that the Company offers provide for a regular annuity payment which changes periodically based on the change in the UK inflation, which, for the majority of policies, is determined by reference to the Retail Price Index (RPI).

The Company remained in a satisfactory financial position at 31 December 2011.

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.

Risks and uncertainties

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.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2011 (continued)

Risks and uncertainties (continued)

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 to the financial statements.

Corporate responsibility

The Company is a wholly owned subsidiary within the Prudential Group and Corporate Responsibility (CR) is integral to the way the Group does business.

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.

As a business that provides savings, income, investment and protection products and services the Group creates social value through its day-to-day operations. First, the Group provides customers with ways to help manage uncertainty and build a more secure future. Second, by playing a key role in financial markets, the Group provides long-term capital that finances businesses, builds infrastructure and fosters growth in both developed and developing countries.

The Group aims to be sustainable in the broadest sense – financially, socially and environmentally. Sustainability is integral to the way it does business. Prudential has long-term liabilities and investments, and its commitments to its customers and its employees, as well as its support for communities and its responsibility towards the environment, are rooted in its aim of continuing to deliver strong financial performance sustainably.

The Group believes that CR is best managed on the ground by those closest to the customer and local stakeholders. Underpinning this approach are the Group's four global CR themes:

1. Customers: Using the Group's financial strength, knowledge and skills to provide fair and transparent products, which meet customers' needs;
2. People: Recruiting, developing and retaining the best people for the best-performing business;
3. The environment: Increasing the efficiency of the Group's business by reducing the direct impact of the properties it occupies and the properties it manages as part of its investment portfolio;
4. Communities: Supporting its communities through donations, employee volunteering and long-term partnerships with charitable organisations that make a real difference.

These themes demonstrate the Group's CR commitments and principles to its stakeholders and provide clarity to its businesses, including the Company, on where they should focus their CR efforts and resources in the context of their individual markets.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2011 (continued)

Corporate responsibility (continued)

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 Board level, the Responsibility Committee comprises senior representatives from the relevant Group functions and each of its core businesses. This committee is responsible for monitoring the Group's CR activities and reviewing CR policies.

Solvency II

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The Solvency II Directive, which sets out the new framework, was formally approved by the Economic and Financial Affairs Council in November 2009 and is anticipated to be transposed into local regulations and take effect for supervisors from 2013, with implementation currently anticipated from 2014. The new approach is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

Specifically, Pillar 1 covers the quantitative requirements around own funds, valuation rules for assets and liabilities and capital requirements. Pillar 2 provides the qualitative requirements for risk management, governance and controls, including the requirement for insurers to submit an Own Risk and Solvency Assessment (ORSA) which will be used by the regulator as part of the supervisory review process. Pillar 3 deals with the enhanced requirements for supervisory reporting and public disclosure.

A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies. Companies may be allowed to make use of internal economic capital models if approved by the local regulator.

The European Parliament is currently discussing the Omnibus II Directive which, once approved, will amend certain aspects of the Solvency II Directive, including the anticipated implementation date as described above. The Omnibus II Directive is expected to be finalised during 2012.

In addition the European Commission is continuing to develop, in consultation with stakeholders including industry, detailed rules that complement the high-level principles in the Solvency II Directive, referred to as 'implementing measures'. These are not expected to be finalised until later in 2012. Further guidance and technical standards are also currently being developed by the European Insurance and Occupational Pensions Authority (EIOPA). These are expected to be subject to a formal consultation and are unlikely to be finalised before early 2013.

There remains significant uncertainty regarding the outcome from this process. There is a risk that the effect of the final measures could be adverse for the Prudential Group, of which the Company is a part, including potentially that a significant increase in capital may be required to support its business and that it may be placed at a competitive disadvantage to other European and non-European financial services groups. The Prudential Group is actively participating in shaping the outcome through its involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Forums, together with the Association of British Insurers (ABI) and Insurance Europe (formerly known as the Comité Européen des Assurances).

Prudential Annuities Limited

Directors' report for the year ended 31 December 2011 (continued)

Solvency II (continued)

Having assessed the requirements of Solvency II, an implementation programme was initiated with dedicated teams to manage the required work across the Group. The activity of the local Solvency II teams is being coordinated centrally to achieve consistency in the understanding and application of the requirements. Prudential Group is continuing its preparations to adopt the regime when it eventually arrives and are undertaking in parallel an evaluation of the possible actions to mitigate its effects. Prudential regularly reviews its range of options to maximise the strategic flexibility of the Group. This includes consideration of optimising the Group's domicile, including as a possible response to an adverse outcome on Solvency II.

Over the coming months Prudential Group will be progressing its implementation and remaining in regular contact with the FSA as it continues to engage in the 'pre-application' stage of the approval process for the internal model.

Retail Distribution Review

The FSA's review of the retail distribution marketplace called the Retail Distribution Review ('RDR') culminated in a policy statement on 26 March 2010. While the rules apply to the Company they will have no practical effect given the Company is closed to new business.

Post balance sheet events

Finance Act 2011 enacted the reduction in corporation tax rate to 26% with effect from April 2011 and 25% from April 2012. The UK Government announced at the Budget 2012 on 21 March 2012 that the corporation tax rate would instead reduce to 24% from April 2012 with two further annual 1% cuts to 22% by April 2014. Other than the enacted changes to 26% and 25%, the effects of the announced changes are not reflected in the financial statements for the year ended 31 December 2011 as they were not enacted at the balance sheet date.

Results and dividends

The state of affairs of the Company at 31 December 2011 is shown in the balance sheet on pages 13 and 14. The profit and loss account appears on pages 11 and 12. An interim dividend of £400m was paid by the Company on 28th December 2011 (2010: £Nil).

Share Capital

There were no changes in share capital during the year (2010: 100,000,000 £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.

Directors

The present directors are shown on page 2. There have been no changes during the year.

Prudential Annuities Limited

Directors' report for the year ended 31 December 2011 (continued)

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' 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 2011 and remain in force.

On behalf of the board of directors.



S D Windridge
Prudential Group Secretarial Services Limited
Company Secretary
23 March 2012

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).

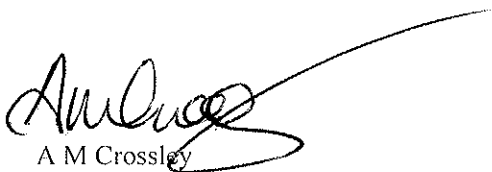
Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

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

23 March 2012

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 2011 set out on pages 11 to 43. 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 8, 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 2011 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 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.

Robert Lewis

Robert Lewis (Senior Statutory Auditor)
For and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL

23 March 2012

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2011

Long Term Business - Technical Account	Note	2011 £m	2010 £m
Earned premiums, net of reinsurance			
Gross premiums written	2(a)	-	1
Intragroup reinsurance accepted	2(a)	(7,650)	-
		(7,650)	1
Investment income	3	1,303	829
Unrealised (losses)/gains on investments		(45)	575
		1,258	1,404
Claims incurred, net of reinsurance			
Claims paid		(697)	(896)
Change in other technical provisions, net of reinsurance			
Long term business provision, net of reinsurance	11	6,674	(180)
Technical provision for linked liabilities, net of reinsurance	11	280	(132)
		6,954	(312)
Net operating expenses			
Administrative expenses		(11)	(12)
Investment expenses and charges		(9)	(10)
		(20)	(22)
Tax attributable to the long term business		53	(41)
Balance on the technical account – long term business		(102)	134

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 15 to 43 form an integral part of these financial statements.

Prudential Annuities Limited

Profit and Loss Account for the year ended 31 December 2011 (continued)

Non-Technical Account	Note	2011 £m	2010 £m
Balance on the long term business technical account		(102)	134
Tax attributable to the balance on the long term business technical account		(53)	41
Investment income	3	101	32
Unrealised gains on investments		34	32
Investment expenses and charges		(1)	(1)
(Loss) / Profit on ordinary activities before tax		(21)	238
Tax on (loss) / profit on ordinary activities	5(a)	19	(59)
Retained (loss) / profit for the financial year transferred to reserves	11	(2)	179

The Company has no recognised gains or losses other than those reported in the profit and loss account.

In accordance with the amendment to Financial Reporting Standard 3 (FRS 3) published in June 1999 no note of historical cost profits has been prepared as the Company's only material gains and losses on assets relate to the holding and disposal of investments.

Reconciliation of movement in Shareholders' Funds

Year ended 31 December 2011	2011 £m	2010 £m
Shareholders' capital and reserves at beginning of year	1,824	1,545
Dividend Paid	(400)	-
New share capital subscribed	-	100
Retained (loss) / profit for the financial year	(2)	179
Shareholders' capital and reserves at end of year	1,422	1,824

The amounts shown above are in respect of continuing operations.

The accounting policies and notes on pages 15 to 43 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2011

ASSETS	Note	2011 £m	2010 £m
Investments			
Land and buildings		579	640
Other financial investments		4,690	11,704
	8	5,269	12,344
Assets held to cover linked liabilities			
	10	1,847	2,127
Reinsurers' share of technical provisions			
Long term business provision	11	5	5
Technical provision for linked liabilities	11	2	2
		7	7
Debtors			
Other debtors	13	11	61
Other assets			
Cash at bank and in hand	16	191	82
Prepayments and accrued income			
Accrued interest and rent		70	232
Total assets	2(b)	7,395	14,853

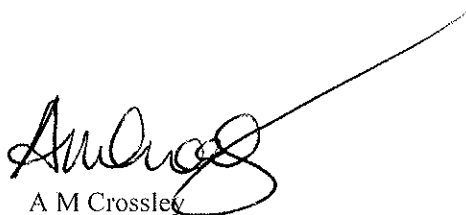
The accounting policies and notes on page 15 to 43 form an integral part of these financial statements.

Prudential Annuities Limited

Balance sheet as at 31 December 2011 (continued)

LIABILITIES	Note	2011 £m	2010 £m
Capital and reserves			
Called up share capital	17	650	650
Profit and loss account	11	772	1,174
Total shareholders' funds		1,422	1,824
Technical provisions			
Long term business provision	11	3,473	10,147
Claims outstanding	11	1	5
Technical provisions for linked liabilities	11	1,849	2,129
Provision for other risks and charges			
Deferred tax	14	133	238
Creditors			
Derivative liabilities	8	237	180
Amounts owed to credit institutions		229	307
Creditors arising out of reinsurance operations		-	1
Other creditors including taxation and social security	15	51	22
		517	510
Total liabilities		7,395	14,853

The financial statements on pages 11 to 43 were approved by the board of directors on 23 March 2012.



A M Crossley
Director

The accounting policies and notes on page 15 to 43 form an integral part of these financial statements.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011

1. Accounting Policies

(a) Change in accounting policies

The Company has implemented the following changes in preparing its results for the year ended 31 December 2011. These standards closely reflect the requirements of International Financial Reporting Standards (IFRS) and form part of the continuing convergence of UKGAAP to IFRS requirements in the UK.

In 2011, the Company adopted the Improvements to Financial Reporting Standards 2010. Their adoption had no material impact on the financial statements of the Company.

(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 2011 (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 a number of different 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) Realised gains and losses on investments

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

(iii) 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:

(iv) 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 2011 (continued)

1. Accounting Policies (continued)

(d) Investments (continued)

(v) *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 2011 (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

	2011 £m	2010 £m
Pension annuities:		
- Level and fixed increasing	-	1
	-	1
Comprising:		
External direct premiums:		
- Immediate annuities	-	1
Total	-	1
Intragroup reinsurance accepted		
	2011 £m	2010 £m
Recapture of Annuities to a related party:		
- Immediate annuities	(7,650)	-
Total	(7,650)	-

All premiums are single premium business written in the United Kingdom. Group pension schemes included in external premiums are £Nil (2010: £1m). The intragroup reinsurance accepted of £7,650m (2010: £Nil) represents the recapture of the annuities back to The Prudential Assurance Company Limited.

(b) Assets attributable to the long term business fund

Of the total assets shown on page 13, £6,606m (2010: £13,976m) is attributable to the long term business fund.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

3. Investment income

	Long term business technical account		Non technical account	
	2011 £m	2010 £m	2011 £m	2010 £m
Income from equity securities	14	14	-	-
Income from land and buildings	38	38	-	-
Income from debt securities	513	689	41	31
Income from mortgage loans and other loans	7	9	-	-
Income from deposits with credit institutions	-	1	-	-
Income from other investments	4	5	-	1
Gains on the realisation of investments other than derivatives	725	72	60	-
Gains on the realisation of derivatives	-	1	-	-
Exchange gains	2	-	-	-
	1,303	829	101	32

4. Staff costs

The Company has no employees (2010: 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

	2011 £m	2010 £m
Current Tax		
UK Corporation tax on profits of the period	86	17
Adjustments in respect of previous periods	-	15
	86	32
Deferred Tax		
Origination and reversal of timing differences	(105)	41
Adjustments in respect of previous periods	-	(14)
	(105)	27
Tax (credit) / charge on (losses) / profits on ordinary activities	(19)	59

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

5. Tax on profit on ordinary activities (continued)

(b) Factors affecting tax charge for the period

	2011 £m	2010 £m
(Loss) / Profit on ordinary activities before tax	(21)	238
(Loss) / Profit on ordinary activities multiplied by effective rate of corporation tax in the UK of 26.5% (2010: 28%)	(6)	67
<i>Effects of</i>		
Adjustments in respect of previous periods	-	15
Timing differences		
- Transfer from the non-technical account in excess of the statutory surplus	100	20
Utilisation of tax losses brought forward	(8)	(70)
Current tax charge for the period	86	32

6. Auditors' remuneration

Fees payable to KPMG Audit Plc (KPMG) for the audit of the Company's accounts and the Company's reporting pack for the Parent's consolidated accounts were £24,000 (2010: £54,000). Fees payable to KPMG for other services pursuant to legislation, including the audit of the regulatory return were £6,000 (2010: £13,000).

7. Directors' emoluments

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

	2011 £	2010 £
Aggregate emoluments and non-pension benefits	84,269	108,604

During the year four (2010: five) directors were entitled to shares under the Prudential's main long term incentive scheme. Two directors are entitled to retirement benefits under defined benefit schemes and three 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 £35,299 (2010: £39,937). 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 2011 (continued)

8. Investments

	Cost		Current Value	
	2011 £m	2010 £m	2011 £m	2010 £m
Freehold land and buildings	247	295	284	358
Leasehold land and buildings	272	293	295	282
Equity securities	224	292	191	259
Debt securities and other fixed income securities	3,499	10,171	4,038	10,816
Derivative assets	-	-	183	101
Loans secured by mortgages	59	118	59	118
Other loans	10	11	10	11
Deposits with credit institutions	209	399	209	399
	4,520	11,579	5,269	12,344

The change in current value of investments included in the profit and loss account was a loss of £22m (2010: gain of £507m) analysed between a loss of £56m (2010: gain of £475m) included in the Long term business technical account and a gain of £34m (2010: gain of £32m) included in the Non-technical account. The change in current value of £56m (2010: gain of £475m) included a gain of £14m (2010: gain of £43m) in respect of land and buildings, a gain of £35m (2010: loss of £15m) in respect of derivatives, a gain of £2m (2010: gain of £8m) in respect of equity securities and a loss of £107m (2010: gain of £439m) in respect of debt securities.

Amounts included in the above ascribed to listed investments:

	Current Value	
	2011 £m	2010 £m
Equity securities	149	212
Debt securities and other fixed income securities	3,698	9,655
	3,847	9,867

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	
	2011 £m	2010 £m
At cost	519	588
Aggregated depreciation	(67)	(59)
Net book value based on historical cost	452	529

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (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.

2011	Fair value through profit and loss	Loans and receivables	Total carrying value	Fair value
£m				
Financial Assets:				
Freehold land and buildings	284	-	284	284
Leasehold land and buildings	295	-	295	295
Deposits with credit institutions	-	209	209	209
Equity securities	191	-	191	191
Debt securities	4,038	-	4,038	4,038
Loans:				
Loans secured by mortgages	-	59	59	60
Other loans	-	10	10	9
Derivative assets	183	-	183	183
Accrued investment income	-	70	70	70
Other debtors	-	11	11	11
Cash at bank and in hand	-	191	191	191
Assets held to cover linked liabilities	1,847	-	1,847	1,847
	6,838	550	7,388	7,388
Financial Liabilities:				
Derivative liabilities	237	-	237	237
Other creditors	-	237	237	237
	237	237	474	474

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

8. Investments (continued)

(a) Financial instruments (continued)

(i) Designation and fair values (continued)

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

As at 31 December 2011 there were no convertible bonds included in debt securities (2010: £Nil). There were no convertible bonds included in borrowings (2010: £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 2011 and 2010.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (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 2011 (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 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 £2,954m (2010: £8,821m), £302m (2010: £1,087m) 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 2011 (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 £80m (2010: £122m) level 3 items which support non-linked annuities backed business 1% (2010: 1%) of the total assets net of derivative liabilities backing this business), £76m (2010: £70m) are externally valued and £4m (2010: £52m) are internally valued. Internal valuations, which represent only 0.1% (2010: 0.5%) 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 £8m (2010 £12.2m), which would reduce or increase shareholders' equity by this amount before tax.

2011	Level 1	Level 2	Level 3	Total
	£m			
Equity securities	-	191	-	191
Debt securities	1,004	2,954	80	4,038
Other investments (including derivative assets)	-	183	-	183
Assets held to cover linked liabilities	206	1,528	-	1,734
Derivative liabilities	-	(237)	-	(237)
Total financial investments, net of derivative liabilities	1,210	4,619	80	5,909
Percentage of total	21%	78%	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 2011 (continued)

8. Investments (continued)

(a) Financial instruments (continued)

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

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%

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 2011 to that presented at 31 December 2011. 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.

2011	At 1 Jan 2011	Total gains in long-term technical account	Purchases	Sales	Transfers into level 3	Transfers out of level 3	At 31 Dec 2011
£m							
Debt securities	122	10	-	(52)	-	-	80
Total financial investments net of derivative liabilities	122	10	-	(52)	-	-	80

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (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)

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

Of the total net gains of £10m (2010: £35m gain) in the period, an £11m gain (2010: £25m 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 £8m for the year ended 31 December 2011 (2010: £11m).

There was no interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2011 (2010: £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 2011 (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.

2011	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	-	-	284	284
Leasehold land and buildings	-	-	295	295
Deposits with credit institutions	-	209	-	209
Equity securities	-	-	191	191
Debt securities	3,657	381	-	4,038
Loans:				
Loans secured by mortgages	59	-	-	59
Other loans	10	-	-	10
Derivatives assets	183	-	-	183
Cash at bank and in hand	-	191	-	191
	3,909	781	770	5,460
Financial Liabilities:				
Derivative liabilities	237	-	-	237
	237	-	-	237

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

8. Investments (continued)

(b) Market risk (continued)

(i) Interest rate risk (continued)

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

(ii) Maturity analysis of derivatives

The net derivative position as at 31 December 2011 was a liability of £54m (2010 : liability of £79m)

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

	2011 £m	2010 £m
Derivative assets	183	101
Derivative liabilities	(237)	(180)
Net Derivative position	(54)	(79)

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 2011 (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 2011 and 2010 are as follows:

2011	Fall of 2%	Fall of 1%	Rise of 1%	Rise of 2%
	£m			
Carrying value of debt securities and derivatives	2,089	905	(723)	(1,318)
Long term business provision	(1,669)	(738)	594	1,080
Related tax effects	(105)	(42)	32	60
Net sensitivity of profit after tax and shareholders' funds	315	125	(97)	(178)

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)

(iv) Currency risk

As at 31 December 2011, the Company held 11% (2010: 4%) and 51% (2010: 38%) 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 2011 (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.

2011

	A decrease of 20%	A decrease of 10%
	£m	
Pre-tax profit	(150)	(75)
Related current tax effects	37	19
Net sensitivity of profit after tax and shareholders' funds	(113)	(56)

2010

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

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 shown the Company has, for 2011, 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 2011 (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.

(d) Credit risk

(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 2011 and 2010:

	Total 2011 £m	Total 2010 £m
S&P – AAA	528	2,797
S&P – AA+ to AA-	478	1,195
S&P – A+ to A-	898	3,296
S&P – BBB+ to BBB-	315	905
S&P – Other	22	108
	2,241	8,301
Moody's – Aaa	909	55
Moody's – Aa1 to Aa3	31	50
Moody's – A1 to A3	63	154
Moody's – Ba1 to Baa3	63	240
Moody's – Other	5	31
	1,071	530
Fitch	38	81
Other	688	1,904
Total debt securities	4,038	10,816

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.

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 2011 which are not externally rated, £436m (2010: £978m) were internally rated AAA to A-, £228m (2010: £907m) were internally rated BBB to B-, £13m (2010: £Nil) were internally rated Other, and £11m (2010: £19m) were unrated.

During the year, S&P withdrew its ratings of debt securities issued by a number of sovereigns. Where these are no longer available, Moody's ratings have been used.

The Company has no exposure to the eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) and no exposure to banking operations in these eurozone countries.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

8. Investments (continued)

(d) Credit risk (continued)

(ii) Loans and receivables

Of the total loans and receivables held £Nil (2010: £5m) are past their due date but have not been impaired. Of the total past due but not impaired, £Nil (2010: £5m) 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 2011, no impairment losses (2010: £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 2011, the Company had lent £613m (2010: £1,472m) of securities and held collateral under such agreements of £647m (2010: £1,580m).

At 31 December 2011, 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 £30m (2010: £93m), together with accrued interest. Of this amount, £Nil (2010: £Nil) related to another group company.

These transactions are conducted under terms that are usual and customary to collateralised transactions including, where relevant, standard securities lending and repurchase agreement

(iv) Collateral under derivative transactions

At 31 December 2011, the Company had pledged £110m (2010: £121m) for liabilities and held collateral of £64m (2010: £31m) in respect of over-the-counter derivatives transactions.

(v) Reinsurer's share of technical provisions

Of the reinsurer's share of technical provisions at 31 December 2011 of £7m (2010: £7m), 100% (2010: 100%) of the balance relates to companies outside of the Prudential Group and of these 100% (2010: 100%) of the balance were from reinsurers with S&P's rating of AA- 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.

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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

Investments (continued)

(c) Risk management (continued)

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 of loss for the Company, or of adverse change in the financial situation, resulting, directly or indirectly, from fluctuations in the level of volatility of market prices of assets and liabilities.

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 for the Company or of adverse change in the financial position, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors in the form of default or other significant credit event (e.g. downgrade or spread widening). 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 2011 (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 £1,012m (2010: £1,150m) reflects the excess of regulatory basis assets over liabilities of the fund, before deduction of the capital resources requirement of £234m (2010: £528m).

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.

	2011 £m	2010 £m
Shareholders' equity		
Held outside long term funds:		
Net assets	968	809
Total	968	809
Held in long term funds	454	1,015
Total shareholders' equity	1,422	1,824
Adjustments to regulatory basis		
Other adjustments to restate these amounts to a regulatory basis	(410)	(674)
Total adjustments	(410)	(674)
Total available capital resources on FSA regulatory bases	1,012	1,150

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

10. Assets held to cover linked liabilities

	Cost		Current Value	
	2011 £m	2010 £m	2011 £m	2010 £m
Assets held to cover linked liabilities	1,356	1,697	1,847	2,127

The change in current value of assets held to cover linked liabilities included in the Long term business technical account was a gain of £11m (2010: gain of £100m).

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 2011	5	2,127	10,142	1,174
Movement in:				
- Movement in technical provisions for the year	(4)	(280)	(6,674)	-
- Dividend payment	-	-	-	(400)
- Profit and loss account	-	-	-	(2)
Balance at 31 December 2011	1	1,847	3,468	772

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, where annuity payments are guaranteed from the outset, or inflation linked. 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 inflation 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 inflation linked contracts provide for a regular annuity payment which changes periodically based on the change in UK inflation, which

- (i) for the majority of contracts is measured by the Retail Price Index (RPI), and
- (ii) 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 2011 (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 2010 and 31 December 2011 are shown below.

The majority of the annuities previously reinsured from The Prudential Assurance Company Limited (PAC) to PAL were recaptured by PAC on 31 August 2011. These recaptured annuities were previously valued as part of the PAL business. The assumptions detailed below as at 31 December 2010, are in respect of the PAL business in aggregate (ie including the now recaptured business), whilst the assumptions at 31 December 2011 are in respect of the post-recapture PAL business only.

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 2011.

The mortality assumptions also include an allowance for expected future improvements in longevity. 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.

Compared with the core CMI mortality model, Prudential's calibration:

- (a) blends period improvements between ages 60 to 80 to the long term improvement rate over a 15 year period (compared with a 20 year period in the core CMI model), and
- (b) assumes that cohort improvements dissipate over a 30 year period, or by age 90 if earlier (compared with a 40 year period, or by age 100 if earlier, in the core CMI model).

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

12. Long term business provisions (continued)

Mortality (continued)

The assumptions used (shown as a range of percentages of base tables with future improvements), before any allowance for impairment, are set out below:

	2011		2010	
	Males	Females	Males	Females
In payment: Business Administered On GPDA System:	126% PNMA00 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 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 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 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.
All other business:	92% - 98% PCMA00 with future improvements in line with Prudential's own calibration of the 2009 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 2009 CMI model, with a long term improvement rate of 1.25%.	92% - 98% PCMA00 with future improvements in line with Prudential's own calibration of the 2009 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 2009 CMI model, with a long term improvement rate of 1.25%.
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.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

12. Long term business provisions (continued)

Interest rate (continued)

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 reduced to 54 basis points per annum (56 basis points per annum at 31 December 2010), which is able to cover a significantly adverse credit situation.

Credit risk provisions

For IFRS reporting, the results are particularly sensitive to the allowances made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest for discounting projected future annuity payments to policyholders that would have otherwise applied. Since mid-2007 there has been a significant increase in the actual and perceived credit risk associated with corporate bonds as reflected in the significant widening that has occurred in corporate bond spreads. Although bond spreads over swap rates have narrowed from their peak in March 2009, they are still high compared with the levels seen in the years immediately preceding the start of the dislocated markets in 2007. The allowance that should therefore be made for credit risk remains a particular area of judgement.

The additional yield received on corporate bonds relative to swaps can be broken down into the following constituent parts:

- (a) the expected level of future defaults;
- (b) the credit risk premium that is required to compensate for the potential volatility in default levels;
- (c) the liquidity premium that is required to compensate for the lower liquidity of corporate bonds relative to swaps; and
- (d) the mark-to-market risk premium that is required to compensate for the potential volatility in corporate bond spreads (and hence market values) at the time of sale.

The sum of (c) and (d) is often referred to as 'liquidity premium'.

The allowance for credit risk comprises

- (i) an amount for long-term best estimate defaults and
- (ii) additional provisions for credit risk premium, downgrade resilience, and short-term defaults.

The weighted components of the bond spread over swap rates for fixed and linked annuity business at 31 December 2011 and 31 December 2010, based on the asset mix at the relevant balance sheet date are shown below.

	Pillar I Adjustment from		
	regulatory	regulatory to	IFRS
	basis	IFRS basis	IFRS
	(bps)	(bps)	(bps)
31 December 2011			
Bond spread over swap rates ^{note (i)}	194		194
Credit risk allowance			
Long-term expected defaults ^{note (ii)}	20	-	20
Additional provisions ^{note (iii)}	68	(34)	34
Total credit risk allowance	88	(34)	54
Liquidity premium	106	34	140

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

12. Long term business provisions (continued)

Credit risk provisions (continued)

31 December 2010	Pillar 1 regulatory basis (bps)	Adjustment from regulatory to IFRS basis (bps)	IFRS (bps)
Bond spread over swap rates ^{note (i)}	170	-	170
Credit risk allowance			
Long-term expected defaults ^{note (ii)}	19	-	19
Additional provisions ^{note (iii)}	68	(31)	37
Total credit risk allowance	87	(31)	56
Liquidity premium	83	31	114

Notes

- (i) Bond spread over swap rates reflect market observed data.
- (ii) Long-term expected defaults are derived by applying Moody's data from 1970 to 2009 and the definition of the credit rating used is the second highest credit rating published by Moody's, Standard and Poor's and Fitch.
- (iii) Additional provisions comprise credit risk premium, which is derived from Moody's data from 1970 to 2009, an allowance for a 1 notch downgrade of the portfolio subject to credit risk, and an additional allowance for short-term defaults.

The very prudent Pillar 1 regulatory basis reflects the overriding objective of maintaining sufficient provisions and capital to ensure payments to policyholders can be made. The approach for IFRS aims to establish liabilities that are closer to 'best estimate'.

Movement in the credit risk allowance for the year ended 31 December 2011

The movement during 2011 of the average basis points allowance on Pillar 1 regulatory and IFRS bases are as follows:

	Pillar 1 Regulatory basis (bps)	IFRS (bps)
	Total	Total
Total allowance for credit risk at 31 December 2010	87	56
Credit rating changes	-	-
Asset trading	(1)	(1)
Asset mix (effect of market value movements)	(6)	(4)
Reinsurance recapture	7	5
Other	1	(2)
Total allowance for credit risk at 31 December 2011	88	54

In prior periods, surplus from favourable default experience has been retained within short-term allowances for credit risk on both the Pillar 1 and IFRS bases. For full year 2011 the retention of such surpluses continues to be applied to IFRS but not for Pillar 1.

Overall the movement has led to the credit allowance for Pillar 1 purposes to be 45 per cent (2010: 51 per cent) of the bond spread over swap rates. For IFRS purposes it represents 28 per cent (2010: 33 per cent) of the bond spread over swap rates.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

12. Long term business provisions (continued)

Credit risk provisions (continued)

The reserve for credit risk allowance at 31 December 2011 on a Pillar 1 regulatory basis was £0.6bn and on an IFRS basis was £0.4bn.

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	2011 £m	2010 £m
Amounts due from group undertakings	11	27
Tax recoverable	-	31
Other debtors	-	3
	11	61

14. Provision for deferred tax

	2011 £m	2010 £m
Unrealised gains on investments	(1)	(6)
Transfer to the non-technical account in excess of the statutory surplus	135	252
Unrelieved losses carried forward	-	(8)
Capital allowances on items expensed in the accounts	(1)	-
Undiscounted provision for deferred tax	133	238
	2011 £m	2010 £m
Deferred tax liability at start of year	238	211
Deferred tax (credit) / charge in profit and loss account	(105)	27
Deferred tax liability at end of year	133	238

From April 2011, the standard corporation tax rate for the UK changed from 28% to 26%. A further reduction in the standard corporation tax rate to 25% from April 2012 has also been enacted. Deferred tax at the end of 2011 has been provided wholly at the rate of 25% 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 2011 is £11m.

Further reductions to the UK corporation tax rate to 23% by 2014 have been proposed but not yet enacted.

Prudential Annuities Limited

Notes to the financial statements for the year ended 31 December 2011 (continued)

14. Provision for deferred tax (continued)

The UK Government has announced that there will be substantial changes to the rules relating to the taxation of life insurance companies, which will be effective 1 January 2013. The effects of these changes are not reflected in the financial statements for the year ended 31 December 2011 as they have not yet been enacted. The new rules will be included in the Finance Bill 2012. Based on the draft legislation published in December 2011, the new regime is not expected to have a material impact on the company's net assets.

15. Creditors

All creditors are payable within a period of five years.

Other creditors including taxation and social security	2011 £m	2010 £m
Taxation	43	17
Other creditors	8	5
	51	22

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 650,000,000 (2010: 650,000,000) £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 £95.1m (2010: £7,312.7m), 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.