Notes on the parent company financial statements

1 Nature of operations

Prudential plc (the Company) is a parent holding company. The Company together with its subsidiaries (collectively, the Group) is an international financial services group with its principal operations in Asia, the US and the UK. In Asia, the Group has operations in Hong Kong, Malaysia, Singapore, Indonesia and other Asian countries. In the US, the Group's principal subsidiary is Jackson National Life Insurance Company. In the UK, the Group operates through its subsidiaries, primarily The Prudential Assurance Company Limited, Prudential Annuities Limited, Prudential Retirement Income Limited and M&G Investment Management Limited. The Company is responsible for the financing of each of its subsidiaries.

2 Basis of preparation

The financial statements of the Company, which comprise the balance sheet and related notes, are prepared in accordance with Part 15 of the Companies Act 2006, which applies to companies generally. The Company has taken advantage of the exemption under Section 408 of the Companies Act 2006 from presenting its own profit and loss account.

The financial statements are prepared in accordance with applicable accounting standards under UK Generally Accepted Accounting Practice (UK GAAP), including Financial Reporting Standards (FRS) and Statements of Standard Accounting Practice (SSAP).

The Company has not prepared a cash flow statement on the basis that its cash flow is included within the cash flow statement in the consolidated financial statements. The Company has also taken advantage of the exemption within FRS 29, 'Financial Instruments: Disclosures', from the requirements of this standard on the basis that the Company's results are included in the publicly available consolidated financial statements of the Group that include disclosures that comply with IFRS 7, 'Financial Instruments: Disclosures', which is equivalent to FRS 29.

The Company adopted the 'Amendment to FRS 29 (IFRS 7) – Financial Instruments: Disclosures – Transfers of Financial Assets' in 2012. The adoption of this amendment did not have an impact on the financial statements of the Company.

3 Significant accounting policies

Shares in subsidiary undertakings
Shares in subsidiary undertakings are shown at the lower of cost and estimated realisable value.

Loans to subsidiary undertakings
Loans to subsidiary undertakings are shown at cost, less provisions.

Derivatives
Derivative financial instruments are held to manage interest rate and currency profiles. Derivative financial instruments are carried at fair value with changes in fair value included in the profit and loss account.

Under FRS 26, 'Financial Instruments: Recognition and Measurement', hedge accounting is permissible only if certain criteria are met regarding the establishment of documentation and continued measurement of hedge effectiveness. For derivative financial instruments designated as fair value hedges, the movements in the fair value are recorded in the profit and loss account with the accompanying change in fair value of the hedged item attributable to the hedged risk.

Borrowings
Borrowings are initially recognised at fair value, net of transaction costs, and subsequently accounted for on an amortised cost basis using the effective interest method. Under the effective interest method, the difference between the redemption value of the borrowing and the initial proceeds, net of transaction costs, is amortised through the profit and loss account to the date of maturity, or, for hybrid debt, over the expected life of the instrument.

Dividends
Interim dividends are recorded in the period in which they are paid. Final dividends are recorded in the period in which they are approved by shareholders.

Share premium
The difference between the proceeds received on issue of shares and the nominal value of the shares issued is credited to the share premium account.

Foreign currency translation

Foreign currency borrowings that have been used to finance or provide a hedge against Group equity investments in overseas subsidiaries are translated at year end exchange rates. The impact of these currency translations is recorded within the profit and loss account for the year.

Other assets and liabilities denominated in foreign currencies are also converted at year end exchange rates with the related foreign currency exchange gains or losses reflected in the profit and loss account for the year.

Tax

Current tax expense is charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year. To the extent that losses of an individual UK company are not offset in any one year, they can be carried back for one year or carried forward indefinitely to be offset against profits arising from the same company.

Deferred tax assets and liabilities are recognised in accordance with the provisions of FRS 19, 'Deferred tax'. The Company has chosen not to apply the option available of recognising such assets and liabilities on a discounted basis to reflect the time value of money. Except as set out in FRS 19, deferred tax is recognised in respect of all timing differences that have originated but not reversed by the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

The Group's UK subsidiaries each file separate tax returns. In accordance with UK tax legislation, where one domestic UK company is a 75 per cent owned subsidiary of another UK company or both are 75 per cent owned subsidiaries of a common parent, the companies are considered to be within the same UK tax group. For companies within the same tax group, trading profits and losses arising in the same accounting period may be offset for the purposes of determining current and deferred taxes.

Pensions

The Company assumes a portion of the pension surplus or deficit of the Group's main pension scheme, the Prudential Staff Pension Scheme (PSPS) and applied the requirements of FRS 17, 'Retirement Benefits' (as amended in December 2006) to its interest in the PSPS surplus or deficit. Further details are disclosed in note 9.

A pension surplus or deficit is recorded as the difference between the present value of the scheme liabilities and the fair value of the scheme assets. The Company's share of pension surplus is recognised to the extent that the Company is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme.

The assets and liabilities of the defined benefit pension schemes of the Prudential Group are subject to a full triennial actuarial valuation using the projected unit method. Estimated future cash flows are then discounted at a high quality corporate bond rate, adjusted to allow for the difference in duration between the bond index and the pension liabilities where appropriate, to determine its present value. These calculations are performed by independent actuaries.

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

Actuarial gains and losses as a result of the changes in assumptions, the difference between actual and expected investment return on scheme assets and experience variances are recorded in the statement of total recognised gains and losses. Actuarial gains and losses also include adjustment for unrecognised pension surplus as described above.

Share-based payments

The Group offers share award and option plans for certain key employees and a SAYE plan for all UK and certain overseas employees. The share-based payment plans operated by the Group are mainly equity-settled plans with a few cash-settled plans.

Under FRS 20, 'Share-based payment', where the Company, as the parent company, has the obligation to settle the options or awards of its equity instruments to employees of its subsidiary undertakings, and such share-based payments are accounted for as equity-settled in the Group financial statements, the Company records an increase in the investment in subsidiary undertakings for the value of the share options and awards granted with a corresponding credit entry recognised directly in equity. The value of the share options and awards granted is based upon the fair value of the options and awards at the grant date, the vesting period and the vesting conditions.

Notes on the parent company financial statements continued

4 Reconciliation from UK GAAP to IFRS

The Company financial statements are prepared in accordance with UK GAAP and the consolidated financial statements are prepared in accordance with IFRS as issued by the IASB and endorsed by the EU. The tables below provide a reconciliation between UK GAAP and IFRS.

	2012 £m	2011 £m
Profit after tax		
(Loss) profit for the financial year of the Company in accordance with UK GAAP	(216)	3,720
IFRS adjustment*	71	(5)
(Loss) profit for the financial year of the Company (including dividends from subsidiaries) in accordance with IFRS	(145)	3,715
Share in the IFRS result of the Group, net of distributions to the Company†	2,342	(2,300)
Profit after tax of the Group attributable to shareholders in accordance with IFRS	2,197	1,415

	2012 £m	2011 £m
Net equity		
Shareholders' equity of the Company in accordance with UK GAAP	6,536	7,357
IFRS adjustment*	–	(44)
Shareholders' equity of the Company in accordance with IFRS	6,536	7,313
Share in the IFRS net equity of the Group†	3,823	1,251
Shareholders' equity of the Group in accordance with IFRS	10,359	8,564

* 'IFRS adjustment' in the above tables represent the difference in the accounting treatment for pension schemes between UK GAAP and IFRS.
† The 'shares in the IFRS result and net equity of the Group' lines represent the Company's equity in the earnings and net assets of its subsidiaries and associates.

The (loss) profit for the financial year of the Company in accordance with UK GAAP and IFRS includes dividends declared in the year from subsidiary undertakings of £501 million and £4,002 million for the years ended 31 December 2012 and 2011, respectively.

As stated in note 3, under UK GAAP, the Company accounts for its investments in subsidiary undertakings at the lower of cost and estimated realisable value. For the purpose of this reconciliation, no adjustment is made to the Company in respect of any valuation adjustments to shares in subsidiary undertakings which would be eliminated on consolidation.

5 Investments of the Company

	2012 £m	
	Shares in subsidiary undertakings	Loans to subsidiary undertakings
At 1 January	10,902	1,200
Transfer of investment in subsidiary undertaking	(3,889)	–
Investment in subsidiary undertaking	4,930	–
Other movements	(14)	–
Foreign exchange movement	–	(36)
At 31 December	11,929	1,164

In January 2012, as part of an internal restructuring, the Company transferred at fair value, interests of £3,889 million in shares in a central subsidiary undertaking and £2,007 million of loans to a second such subsidiary to another central subsidiary in exchange for shares issued by that subsidiary of £4,930 million, and settlement of an amount owed to that subsidiary of £966 million. No profit or loss arose on the transfer.

Other movements comprise £6 million in respect of share-based payments reflecting the value of payments settled by the Company for employees of its subsidiary undertakings in 2012 offset by cash of £20 million received from those subsidiaries.

The principal subsidiary undertakings of the Company at 31 December 2012 are disclosed in note I8(i) 'Subsidiary undertakings – Principal subsidiaries' of the Group financial statements.

6 Deferred tax asset

	2012 £m	2011 £m
Short-term timing differences	3	6
Unused deferred tax losses	44	358
Total	47	364

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

For each category of deferred tax asset recognised, its recoverability against forecast taxable profits is not significantly impacted by expected changes to accounting standards.

The UK government's tax rate change to 23 per cent has had the effect of reducing the Company's net deferred tax balance at 31 December 2012 by £3 million. The change to 23 per cent is effective from 1 April 2013 but is substantively enacted as at 31 December 2012. The subsequent proposed rate change to 21 per cent by 1 April 2014 is not expected to have a material effect on the deferred tax balance recognised at 31 December 2012.

7 Borrowings

	Core structural borrowings		Other borrowings		Total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Core structural borrowings[notes (i) and (v)]	3,126	3,201	–	–	3,126	3,201
Other borrowings:						
Commercial paper[note (ii)]	–	–	1,535	2,706	1,535	2,706
Floating Rate Notes 2013[note (iii)]	–	–	200	200	200	200
Medium-Term Notes 2013[notes (ii) and (v)]	–	–	250	250	250	250
Medium-Term Notes 2015[note (ii)]	–	–	299	–	299	–
Total borrowings	3,126	3,201	2,284	3,156	5,410	6,357
Borrowings are repayable as follows:						
Within 1 year or on demand	–	–	1,985	2,906	1,985	2,906
Between 1 and 5 years	–	–	299	250	299	250
After 5 years	3,126	3,201	–	–	3,126	3,201
	3,126	3,201	2,284	3,156	5,410	6,357

	2012 £m	2011 £m
Recorded in the balance sheet as:		
Subordinated liabilities[note (iv)]	2,577	2,652
Debenture loans	549	549
	3,126	3,201

Notes

(i) Further details on the core structural borrowings of the Company of £3,126 million (2011: £3,201 million) are provided in note H13 'Borrowings' of the Group financial statements.

(ii) These borrowings support a short-term fixed income securities programme.

(iii) The Company issued £200 million Floating Rate Notes in 2012 which mature in April 2013. All Notes have been subscribed to by a Group subsidiary and accordingly have been eliminated on consolidation in the Group financial statements. These Notes were originally issued in October 2008 and have been reissued upon their maturity.

(iv) The interests of the holders of the subordinated liabilities are subordinate to the entitlements of other creditors of the Company.

(v) In January 2013, the Company issued core structural borrowings of US$700 million 5.25 per cent Tier 1 perpetual subordinated capital securities. The proceeds, net of costs, were US$689 million. Also in January 2013, the Company repaid the £250 million Medium-Term Notes 2013 on maturity.

Notes on the parent company financial statements continued

8 Derivative financial instruments

	2012 £m		2011 £m	
	Fair value assets	Fair value liabilities	Fair value assets	Fair value liabilities
Cross-currency swap	3	–	3	–
Inflation-linked swap	–	190	–	207
Total	3	190	3	207

Derivative financial instruments are held to manage interest rate and currency profiles. The change in fair value of the derivative financial instruments of the Company was a gain before tax of £17 million (2011: loss before tax of £75 million).

The derivative financial instruments are valued internally using standard market practices. In accordance with the Company's risk management framework, all internally generated valuations are subject to independent assessment against external counterparties' valuations.

9 Pension scheme financial position

The majority of UK Prudential staff are members of the Group's pension schemes. The largest scheme is the Prudential Staff Pension Scheme (the 'Scheme') which is primarily a closed defined benefit scheme.

For the purpose of preparing consolidated financial statements, the Group applies IFRS basis accounting including IAS 19, 'Employee Benefits' as described further in note I3 'Staff and pension plans' of the Group financial statements (note I3). Although the individual accounts of the Company continue to follow UK GAAP, the disclosures under FRS 17, 'Retirement Benefits' are aligned with IAS 19.

At 31 December 2005, the allocation of surpluses and deficits attaching to the Scheme between the Company and the unallocated surplus of the The Prudential Assurance Company Limited (PAC) with-profits fund was apportioned in the ratio 30/70 following detailed consideration of the sourcing of previous contributions. This ratio was applied to the base deficit position at 1 January 2006 and for the purpose of determining the allocation of the movements in that position up to 31 December 2012. The FRS 17 service charge and ongoing employer contributions are allocated by reference to the cost allocation for current activity.

The last completed triennial actuarial valuation of the Scheme was as at 5 April 2011. Further details on the results of this valuation and the total employer contributions to the Scheme for the year are provided in note I3, together with the key assumptions adopted, including mortality assumptions.

Using external actuarial advice provided by the professionally qualified actuaries, Towers Watson, for the valuation of the Scheme, the most recent full valuations have been updated to 31 December 2012 applying the principles prescribed by FRS 17. The long-term expected rates of return have been determined after applying due consideration to the requirements of paragraph 54 of FRS 17, in particular, taking account of the values of the assets, and are set out below:

	Prospectively for 2013 %	2012 %	2011 %
Equities	**6.7**	6.8	8.2
Bonds	**2.8**	3.0	4.6
Properties	**5.5**	5.55	6.9
Other assets	**2.0**	2.0	4.75
Weighted average long-term expected rate of return	**2.9**	3.1	5.1

The assets and liabilities of the Scheme were:

	31 Dec 2012		31 Dec 2011		31 Dec 2010		31 Dec 2009		31 Dec 2008	
	£m	%	£m	%	£m	%	£m	%	£m	%
Equities	43	0.7	210	3.3	548	10.3	830	16.8	823	17.1
Bonds	5,440	81.2	5,547	86.2	3,864	72.2	3,406	68.8	2,430	50.6
Properties	290	4.5	297	4.6	199	3.7	272	5.5	283	5.9
Other assets	627	13.6	378	5.9	740	13.8	441	8.9	1,267	26.4
Total value of assets	6,400	100.0	6,432	100.0	5,351	100.0	4,949	100.0	4,803	100.0
Present value of Scheme liabilities	(5,226)		(4,844)		(4,866)		(4,436)		(4,075)	
Underlying surplus in the Scheme	1,174		1,588		485		513		728	
Surplus in the Scheme recognised by the Company	49		52		56		52		50	
Amounts reflected in the balance sheet of the Company, net of deferred tax	38		39		41		37		36	

The surplus in the Scheme recognised in the balance sheet of the Company represents the element of the amount which is recoverable through reduced future contributions and is net of the apportionment to the PAC with-profits fund.

Underlying Scheme liabilities and assets

The change in the present value of the underlying Scheme liabilities and the change in the fair value of the underlying Scheme assets are as follows:

	2012 £m	**2011** £m
Present value of Scheme liabilities, at 1 January	4,844	4,866
Current service cost	21	22
Past service cost*	106	(216)
Interest cost	227	254
Employee contributions	1	1
Actuarial losses	252	131
Benefit payments	(225)	(214)
Present value of Scheme liabilities, at 31 December	5,226	4,844

* The past service cost in 2012 of £106 million resulted from an exceptional discretionary increase to pensions in payment of the Scheme awarded during the year. The negative past service cost in 2011 of £216 million related to the effect of the change of the basis of indexation from Retail Price Index to Consumer Price Index.

	2012 £m	**2011** £m
Fair value of Scheme assets, at 1 January	6,432	5,351
Expected return on Scheme assets	201	267
Employee contributions	1	1
Employer contributions†	36	54
Actuarial (losses) gains	(45)	973
Benefit payments	(225)	(214)
Fair value of Scheme assets, at 31 December	6,400	6,432

† The contributions include deficit funding, ongoing service contributions and expenses.

Notes on the parent company financial statements continued

9 Pension scheme financial position continued

Pension (charge) credit and actuarial (losses) gains of the Scheme and attributable to the Company

The pension (charge) credit of the Scheme and the charge recognised in the Company's profit and loss account are as follows:

Pension (charge) credit:	2012 £m	2011 £m
Operating charge:		
Current service cost	(21)	(22)
Past service cost	(106)	216
Finance (expense) income:		
Interest on Scheme liabilities	(227)	(254)
Expected return on Scheme assets	201	267
	(26)	13
Total pension (charge) credit of the Scheme	(153)	207
Pension charge attributable to the Company	(53)	(10)

The pension charge attributable to the Company is net of the apportionment to the PAC with-profits fund and is related to the surplus recognised on the balance sheet of the Company. In 2011, an amount of £65 million was applied to extinguish the negative past service cost attributable to the Company from the unrecognised portion of the pension surplus at 31 December 2011. No adjustment was made to the pension charge in 2012 relating to the unrecognised portion of the Scheme's surplus.

Actuarial (losses) gains:	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Actual less expected return on Scheme assets (1% (2011: 15%) (2010: 5%) (2009: 2%) (2008: 5%) of assets)	(45)	973	275	85	(259)
Experience (losses) gains on Scheme liabilities (0% (2011: 6%) (2010: 0%) (2009: 1%) (2008: 3%) of liabilities)	(19)	295	1	59	127
Changes in assumptions underlying the present value of Scheme liabilities	(233)	(426)	(370)	(374)	200
Total actuarial (losses) gains (6% (2011: 17%) (2010: 2%) (2009: 5%) (2008: 2%) of the present value of Scheme liabilities)	(297)	842	(94)	(230)	68
Actuarial gains (losses) attributable to the Company before tax	35	(16)	(14)	(3)	(143)

The total actual return on Scheme assets was a gain of £156 million (2011: £1,240 million).

The experience gains on Scheme liabilities in 2011 of £295 million related mainly to the 'true-up' reflecting improvements in data consequent upon the 2011 triennial valuation of the Scheme. Similarly, the experience gains of £127 million in 2008 were related mainly to the improvements in the data consequent to the 2008 triennial valuation.

The actuarial gains (losses) attributable to the Company are net of the apportionment to the PAC with-profits fund and are related to the surplus recognised in the balance sheet of the Company. In 2012, the actuarial losses attributable to the Company included an amount credited of £124 million (2011: amount charged of £268 million) for the adjustment to the unrecognised portion of surplus which has not been deducted from the pension charge.

The actuarial gains before tax of £35 million (2011: losses of £16 million) attributable to the Company are recorded in the statement of total recognised gains and losses. Cumulative actuarial gains as at 31 December 2012 amount to £93 million (2011: £58 million).

Total employer contributions expected to be paid into the Scheme for the year ending 31 December 2013 amount to £11 million, reflecting the annual accrual cost and expenses.

10 Share capital and share premium

A summary of the ordinary shares in issue and the options outstanding to subscribe for the Company's shares at 31 December 2012 is set out in note H11 'Shareholders' equity: share capital, share premium and reserves' of the Group financial statements.

11 Profit of the Company and reconciliation of the movement in shareholders' funds

The loss after tax of the Company for the year was £216 million (2011: profit of £3,720 million). After dividends of £655 million (2011: £642 million), actuarial gains net of tax in respect of the pension scheme of £27 million (2011: losses of £12 million) and share-based payment credits of £6 million (2011: £7 million), retained profit at 31 December 2012 amounted to £4,519 million (2011: £5,357 million). Retained profit includes £2,734 million relating to gains made by an intermediate holding company following the transfer at fair value of certain of its subsidiaries to other parts of the Group as part of an internal restructuring exercise in 2011. Because the gains relate to intragroup transactions, the amount of £2,734 million is not able to be regarded as part of the distributable reserves of the parent company. Under English company law, Prudential may pay dividends only if sufficient distributable reserves of the Company are available for the purpose and if the amount of its net assets is greater than the aggregate of its called up share capital and undistributable reserves (such as for example the share premium account) and the payment of the dividend does not reduce the amount of its net assets to less than that aggregate. At 31 December 2012, the UK GAAP retained earnings of the holding company from which distributable reserves may be derived were £4,519 million.

A reconciliation of the movement in shareholders' funds of the Company for the years ended 31 December 2012 and 2011 is given below:

	2012 £m	2011 £m
(Loss) profit for the year[note 4]	(216)	3,720
Dividends	(655)	(642)
	(871)	3,078
Actuarial gains (losses) recognised in respect of the pension scheme, net of related tax[note 9]	27	(12)
Share-based payments[note 5]	6	7
New share capital subscribed	17	17
Net (decrease) increase in shareholders' funds	(821)	3,090
Shareholders' funds at beginning of year	7,357	4,267
Shareholders' funds at end of year[note 4]	6,536	7,357

12 Other information

a Information on directors' remuneration is given in the directors' remuneration report section of this Annual Report and note I5 'Key management remuneration' of the Group financial statements.

b Information on transactions of the directors with the Group is given in note I7 'Related party transactions' of the Group financial statements.

c The Company employs no staff.

d Fees payable to the Company's auditor for the audit of the Company's annual accounts were £0.1 million (2011: £0.1 million) and for other services were £0.6 million (2011: £nil).

e In certain instances the Company has guaranteed that its subsidiaries will meet their obligations when they fall due for payment.

13 Post balance sheet events

In January 2013, the Company issued US$700 million 5.25 per cent Tier 1 perpetual subordinated capital securities. The proceeds, net of costs, were US$689 million. Also in January 2013, the Company repaid £250 million Medium-Term Notes 2013 on maturity.

Subject to shareholders' approval, in May 2013 the Company will pay a final dividend for the year ended 31 December 2012. Further details are provided in note B3 'Dividends' of the Group financial statements.